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IN THIS ISSUE

Decisions are being made on six state issues which could have major impacts far beyond those states where the issue is hot. The six possible turning points are: cutting government in Massachusetts, welfare reform in New Jersey, sick taxes in Virginia, business taxes in Florida, Medicaid reform in Oregon, and financing schools in Texas.

- Six Critical Decisions p. 2
- Retrenchment p. 3
- Balanced Welfare Reform p. 4
- Health Provider Taxes p. 6
- Unconventional Business Taxes p. 6
- Rationing Health Care p. 7
- Financing Schools p. 8

Officials in many states, such as California and Illinois, are having extreme difficulty making budget decisions this year. The reasons have nationwide implications.

- Fiscal Strategies p. 9

Major reforms in health care financing are producing no action but a blizzard of paper at state and federal levels -- plans, studies, proposals, bills, and detailed criticisms of each. Medicaid costs spiral with cost-cutting often failing, while cost-increasing efforts work.

- Health Financing Update p. 12

With state spending stagnant, university administrators are telling legislators they will cut quality or serve fewer students, maybe both.

- Higher Education Strategy p. 17

New York could be the first state to enter FY 1993 without an approved budget. Many states could end FY 1992 in deficit -- causing a reexamination of what balanced budget requirements really mean.

- Resolving New York's Finances p. 20
- Balanced Budgets And Revenue Estimating p. 24

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March 1992 (First Of Two March Issues)

SIX CRITICAL DECISIONS

Important And "Hot," But Routine, State Issues

In Issue 3, **Reports** drew on state-of-the-state messages, surveys of legislators, and other sources to summarize major state issues in 1992. Many of these issues are well understood, new alternatives aren't being offered, and the arguments for and against policies haven't changed. Examples are capital punishment, how much to rely on tuition to finance higher education, and how much to pay state employees and teachers. While there is value in monitoring these issues in 50 states, decisions on them in one state don't make decisions in another state much easier.

Significant Turning Points

This article takes a different look, attempting to select the states and issues where developments in one state may well spread to others. Proposition 13 in California was one such issue. After California voters approved it, its property-tax-limiting features were debated in nearly every state, and adopted in many. The California action wasn't significant because imposing a property tax limit was a new idea, nor because California drafters invented a better way to implement it. The impact arose because of an essentially political demonstration that strict property tax limits were an idea whose time had apparently come.

The six issues, representing possible turning points in state policy -- six situations worth watching -- are shown below.

Critical Issues And Battlegrounds, 1992

Issue	Primary Battleground	Other Battlegrounds
Retrenchment	Massachusetts	Michigan
Balanced Welfare Reform	New Jersey	Vermont
Health Provider Taxes	Virginia	Iowa, Oklahoma
Unconventional Business Taxes	Florida	Nevada, New Hampshire, Washington
Rationing Health Care	Oregon	Colorado
Financing Schools	Texas	Kansas, Oregon, Tennessee

Not every observer would necessarily pick the same six issues. But **Reports** has some advantages over other observers -- a multi-state perspective, no dues-paying members and thus no internal politics to affect selections, and readers who tolerate complex treatments of complex choices rather than good guys, bad guys journalistic over-simplifications. The selections omit many issues that some readers (and perhaps the editors) believe *should be* on the list but don't appear because major decisions about them don't seem to be in the cards this year. Examples: school choice and a new round of education reform, tax reform, universal health care plans, and privatization.

RETRENCHMENT

Usual Responses To Tight Times -- Raise Taxes, Cut Programs

Recession-retarded revenue growth, inflation, federal mandates, growing caseloads in income-tested programs in practically all states, and growing school enrollments in many sates combine to dictate the curtailment of current state services or tax increases in most states. Some states will respond by significant tax increases. Some will respond by borrowing, selling assets, or other financial maneuvers that put off long-term budget-balancing decisions. Some will respond with service cuts.

Unusual Responses To Tight Times In Massachusetts -- Cut Taxes, Cut Programs

Almost none of the states -- when all is said and done, maybe none -- will respond to the situation by cutting taxes. This is why Governor Weld's tax-cutting proposals in **Massachusetts** (described in Issue 4) have drawn so much interest. Massachusetts is already on its tax-cutting course. The sales tax on services was repealed last year. The income tax rate was lowered in January. The next action will be on the new tax reduction proposals and the FY 1993 budget, both scheduled for decision before July.

Even if the governor's proposals are adopted, the retrenchment policy will not be fully tested until at least 1993. Massachusetts in 1991-1992 parallels the federal situation in 1981, when President Reagan took office. Democratic majorities in the legislative bodies haven't bucked the chief executive on tax cutting issues. But they are reluctant to adopt recommended spending cuts. Some outside observers believe that even if enacted exactly as proposed, Governor Weld's package would produce a deficit, parallel to the federal one produced in the "bidding war" to cut federal taxes. The difference lies in the state's inability to match the federal government's capacity to run large deficits indefinitely.

Unusual Responses To Tight Times In Other States

Cutting taxes and thereby restraining spending has enormous appeal, even when state and local budgets are clearly tight. Majorities in the **New Jersey** legislature are determined to lower the sales tax rate by one cent. **Pennsylvania**'s governor has recommended that the "temporary" income tax increase adopted last year expire on schedule this summer. Governor Symington's tax cut recommendation in **Arizona** is also an example, but the state's chaos level (e.g., governor fighting criminal charges, legislature facing backlash on its ethics) and unique problems (e.g., its non-Medicaid indigent health financing arrangement) make the state an imperfect model for other states. Because voters rejected the tax measures put on the November ballot by the governor and legislature, some temporary taxes are expiring in **Missouri** this year.

Attempts to limit local property taxes are common in many states, particularly in the West where in some states they appear nearly every year. Although old news, the limit approved by **Oregon** voters will start to have its major bite this year. After spending the better part of a year feeling voters' pulses, Oregon's governor says she will not be pushing for compensating higher state taxes this year. As a result, to comply with the mandate that the state fund local losses, state spending on other activities may be curtailed sharply. Officials in other states, particularly **Colorado** and **Idaho**, are considering their fiscal choices this year with one eye on the repercussions for passage of similar voter initiatives in their states.

The runner-up to the Bay State as an example of possible retrenchment is **Michigan**, which differs primarily because the governor's pressure is on local property taxes, not state taxes. Governor Engler's budget is tighter than Governor Weld's in some areas, particularly elementary and secondary education.

BALANCED WELFARE REFORM

Typical Debates Over Welfare

Welfare dependency is a social, fiscal, political, and law enforcement problem that won't quit. The predominant form of state welfare debate is a bitter, usually partisan exchange. Both sides condemn welfare dependency. One side concludes that payments should be lower or at least not raised, eligibility should be tightened or at least not increased, and that recipients should be required to do something more such as taking jobs, going to school, keeping children in school, and/or paying their landlords. The other side accuses the first of being heartless and lacking compassion, failing to recognize the needs of the poor, and shortchanging innocent children. The case is argued everywhere, with articulate debates between the governor and legislative leaders in **Wisconsin** a good example.

Pressures For Compromise In California

As Governor Wilson (R) takes his welfare-cutting initiative to the public, **California**'s debate will gain more national attention than it already has. Before the voters see the benefit-cutting initiative on the November ballot, the legislature will have to act on welfare in the context of the FY 1993 budget. Legislative leaders (D) are clearly worried. House Speaker Willie Brown recently told the press that "fear of voter punishment as a result of trying to defend the so-called welfare system" concerns everyone in his party's caucus. His policy assessment is:

> *We have got to try to separate out the part of the welfare system that drives us all mad, and take care of the part that is really appropriate and reflective of good human concerns for each other.*

To the dismay of some California advocates for the poor, Brown indicated that House Democrats would likely support many features of proposed welfare reforms including: (1) lower benefits for new California residents, (2) limits on benefits for able-bodied adults who won't take available jobs that pay decent wages, (3) public service work requirements for those who don't find private sector work, and (4) continuing income-tested benefits like Medicaid and child care for former recipients who take jobs and otherwise would lose eligibility.

Failures Of Past Compromises

Legislators in California and elsewhere would love to find an affordable solution that could command bipartisan support. This is what they though they had in the late 1980s, when some states experimented with programs to put welfare recipients to work with apparent success. The governors of both parties sold a reasonably enthusiastic Congress on welfare reform measures built upon programs like California's GAIN and Massachusetts' ET. Success has been elusive. Dramatic gains in employment of welfare recipients haven't occurred. Welfare rolls have increased. States have been reluctant to undertake the programs now required of all of them by the federal legislation. GAIN, ET, and their clones are being cut back by the states that pioneered them. Some states are not using all the federal matching money available for these programs.

New Legislation in New Jersey

In this context, **New Jersey**'s welfare reform measure (Issue 3) signed by the governor in January is amazing politically, if not substantively. The lame duck session passed it by wide bipartisan margins in a legislative session so partisan that one party was trying to prevent action on anything by refusing to show up (thereby avoiding quorums) and the other party was trying to repeal taxes everyone agreed were necessary to maintain a balanced budget. The measure recognized both some actions previously viewed as punitive (e.g., not increasing monthly checks for children born while a recipient is on welfare) and some previously viewed as too liberal (e.g., not requiring a new stepparent to assume full financial responsibility for children already in the household).

If the necessary federal waivers are approved, the New Jersey legislation will be in effect in July. In other states, legislators will pick and choose among the punitive and liberal aspects, many of which were already on their agendas. Whether any other state will be able to adopt such sweeping change remains to be seen. Of course, everyone will want to know whether the changes work, but hard evidence on that won't start to be available until 1993.

HEALTH PROVIDER TAXES

There are many ways to make one health consumer pay for another consumer's care, which is basically what country doctors did when they treated some patients for nothing, some for chickens, some for whatever they could pay, and some for the going rate. With specialization among health care providers and competition among third-party payors, more formal mechanisms have been required to maintain these cross-subsidies.

These can be established without money flowing through state general funds, as **New Jersey**, among other states, has done with an uncompensated care fund financed by what amounts to a 20% gross receipts tax on hospitals. To pick up the federal matching money through Medicaid, states must collect this money, though some states have been keeping the action out of their general funds by establishing special funds.

With the donations programs ruled out by new federal rules, the money must come from all providers (or all taxpayers), which inherently includes some that will contribute more to such funds than the benefits they receive. **Virginia**'s situation (Issue 4) is important because it will show what happens when some of the providers decide to fight these taxes. Politically, it will be a lesson for elected officials on the costs of proposing them and a lesson for providers on the costs of opposing them.

Oklahoma legislators are discussing taking the issue to the voters, which could lead to an interesting campaign. This unusual, and constitutionally unnecessary, step is a serious choice because of strong opposition to a tax increase several years ago. The expectation was that if passed as a regular measure, its provisions would be suspended by voter referral procedures. The measure was held in the legislature until a two-thirds vote could be obtained so it could go into effect immediately. It did, but it then went to voters in the stronger position of an existing tax, not a proposed tax, and was narrowly approved. Now an initiative is being pushed to require all tax increases to go to the voters. Legislative enactment of a "sick tax" would presumably give the initiative's proponents more ammunition.

UNCONVENTIONAL BUSINESS TAXES

While it has few advocates among elected officials, state or federal, or among business leaders, the value added tax keeps appearing in discussions of tax policy. It has serious state-level advocates like Gerald Miller, who served as the executive director of the state budget officers in the 1980s. The VAT keeps cropping up in state tax study reports. Michigan has used the concept for decades, with no sign of change. It appears frequently in tax policy discussions in other states such as **Louisiana**, **Nevada**, and **New Hampshire**. This year it is part of the governor's program in **Florida**.

Don't count the value added tax concept as being dead. The widely used argument for universal health insurance -- only the U.S. and one other major country don't have it -- is an argument for VAT also. The former states of the USSR are adopting theirs now. The argument against current health policy -- there are hundreds of dollars more in health costs in an American car's price than in a Japanese one -- is an argument for substituting VAT for the corporate income tax. Under the General Agreement on Trade and Tariffs, nations can rebate the VAT component of goods sold for export, but cannot rebate the portion of costs attributable to national and state taxes on corporate income.

VAT also responds to the concern that economic activity escapes taxation because it is carried out by proprietorships, partnerships, corporations not organized to make a profit, and for-profit corporations in unprofitable years. This is a particularly vexing problem in states like **Nevada**, **New Hampshire**, and **Texas** that don't tax individual income. Owners can raise their salaries to convert taxable profits to untaxed income.

The immediate prospects for the tax in **Florida** are limited. Many legislators don't want to raise taxes at all. Those that do are more interested in tax changes to help finance the new FY 1993 budget than the governor's VAT proposal which wouldn't have significant revenue effects until FY 1994.

RATIONING HEALTH CARE

The standard methods for trying to cut Medicaid costs fall into simple categories: (1) reducing the number of people eligible, (2) cutting reimbursement rates paid providers, and (3) somehow becoming more efficient, such as by using managed care. Cutting services to an eligible recipient is a limited alternative under current law. States now providing optional services (e.g., podiatry) can drop them and limits on extreme utilization (e.g., limits on physician visits per month often considered in New York) can be adopted.

The **Oregon** experiment has received widespread publicity because it offers a potentially better idea, setting priorities among services to be covered. It has drawn considerable interest in other states, but no action. At the moment, there is no Oregon Plan for other states to copy. Oregon needs a controversial federal waiver. If this is achieved, Oregon can implement its plan, though the legislature will have at least one more opportunity to decide not to do so.

While explicit rationing has been considered in other states, such as **Colorado**, the idea now appears to be on hold. Implementation in other states wouldn't offer immediate budget relief because they would presumably opt for a long consultation process like Oregon's. Whether a federal waiver would be granted is unknown, at least until there is action on Oregon's plan.

FINANCING SCHOOLS

Two constraints prevent **Texas** from having school finance equalization systems resembling those in the states -- like **California**, **Kentucky**, and **New Mexico** -- that have nearly full equalization. First, it has no personal income tax and its voters don't seem to want one. Second, it has a constitutional prohibition against a statewide property tax.

When the state supreme court required equalization the first time, the state raised the sales tax to pump new state money into poor districts. When the court threw that out as not enough, the state responded by increasing the sales and other taxes and creating fiscal districts to collect a county education tax. The new levy was designed to have the economic impact of a statewide property tax but not to be one in the eyes of the law.

NO said the richer school districts -- if it's designed to have the effects of a statewide property tax then it is one. In late January by a 7-2 margin, the state supreme court agreed that the new arrangement violates the state constitution. BUT, the justices (many up for election in November) said, legislators (also up in November) could treat the tax as constitutional until the summer of 1993, but no longer. The aspect of the decision permitting additional collections of an unconstitutional tax is under collateral attack in federal courts. (See State Budget & Tax News, 2/12 for more detail.)

Considerable brainpower will now go into designing something that: (1) provides equalization, (2) doesn't result in a statewide property tax, and (3) doesn't take so much state money that it requires a state income tax or equally awful alternatives like double-digit sales taxes. Such a plan could conceivably be developed, but the result would be difficult to explain, even more difficult to sell to legislators and the public, unpalatable to taxpayers in rich districts, and again subject to litigation. Another possibility, which hasn't received much attention, is to alter the state constitution to give the legislature, not the courts, clear authority to decide what equalization means. Texas officials and experts are now debating alternatives, with a special session of the legislature possible. They have what would be considered a dream question in a classroom. If you had to design a state-local tax system from scratch, what would you do? How much sales tax? What split of revenue between state and local government governments? How large would school districts be?

Haven't I Heard That Somewhere Before?

The state-of-the-state and budget messages often have more than one governor claiming to be first in the nation in something. Example: Governor Bayh told the Indiana legislature about the FY 1992 budget, "the final result -- no tax increases, more money for education, and a healthy surplus -- makes Indiana the envy of other states." Not the envy of Michigan whose governor said, "As a result, Michigan became the only state in America to significantly reduce a massive budget deficit, increase funding for education, and hold the line on taxes."

FISCAL STRATEGIES

Traditional Budget And Tax Battles

Some elected officials want lower taxes and less government and some want higher taxes and more services. During a legislative session, these forces bang on each other, mobilize public support, search for majorities, and conclude with a budget. This classic fiscal drama is being played this year in states like **California**, **Florida**, **Maryland**, **Mississippi**, and **New York**. Most years, there are good shows in **Minnesota** and **Wisconsin**, but their officials are taking a mid-biennium break.

Oversimplifying, the players can be thought of in three groups: (1) **the shrinkers**, known pejoratively as "Neanderthals," who want the state's role and tax burdens reduced, (2) **the fiscal managers**, who aren't looking for major changes in the state role, and (3) **the expanders,** known pejoratively as the "tax-and-spend crowd," who want to do more and better in education, infrastructure and/or social services. Pure cases of expanders and shrinkers aren't often found in leadership positions. They tend to be held by those subscribing to the prevailing public view that services should be expanded *and* taxes reduced. The pure cases will be found among the backbenchers ~~of~~ nearly every legislature.

Real World Fiscal Strategies

It takes immense pressure to make major changes in state spending and taxes. So the big battles over fiscal issues come at crisis periods when there is a mismatch of spending and revenues too large to be ignored. Business cycles interact with state finances to produce these crises often, including now in most states. Savvy shrinkers, expanders, and fiscal managers have different strategies for the stages of the cycle as shown below.

Budget Strategies For Expanding, Shrinking, Or Maintaining State Financial Roles

Economic/ Budget Situation	Budget And Tax Strategy For: Shrinking	Expanding	Maintaining
Normal Growth/	Spend Income, Seek Tax Cuts	Spend Income, Seek Tax Hikes	Spend Income No Tax Changes
Rapid Growth/ Budget Surplus	Spend Below Income Cut Taxes	Spend Income No Tax Changes	Spend Below Income Build Reserves, Rainy Day Funds No Tax Changes
Recession/ Budget Deficit	Spend Income No Tax Changes	Spend Above Income Increase Taxes	Spend Above Income No Tax Changes

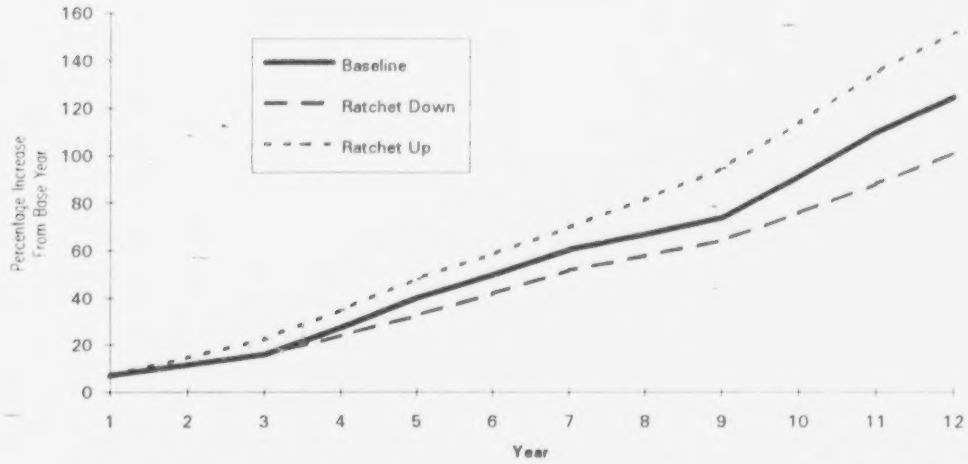
The shrinkers get their best shot at cutting back spending levels in recessions. If successful in resisting tax increases and fiscal gimmicks then, they should find that the rapid revenue growth and unexpected surpluses associated with economic recovery provide fertile grounds for tax cutting. Conversely, the expanders get their best shot in recovery periods when growth provides for apparently costless increases and the promises of future increases common in state school aid legislation. Come recession, a tax increase becomes a necessity to avoid painful cutbacks. If increased, the new tax levels become a starting point for the next cycle.

The challenge for the fiscal managers has always been to avoid these extremes. In good times, they husband resources by building reserves, accelerating payment schedules, making extra contributions to retirement funds, filling the coffers of rainy day funds, and spending on one-time items like capital outlays. In bad times, they reverse these strategies.

Impact Of The Strategies

Over the course of several business cycles, how successful these strategies are has immense impacts on the levels of state spending and taxes. The graph compares the results of a decade of each strategy at work. It is based on a **Reports** simulation of results when steady economic growth and inflation produce average annual revenue increases of about 7%, with no tax increases or cuts, and keep a state's share of personal incomes about constant.

Increase In Budgets
Using Three Strategies



The baseline reflects fluctuations in the rate of growth because of business cycles which drop the growth rate to 4% in some years and an offsetting 10% in other years. The line is the result if "maintainers" hold spending to revenues, no more and no less. If they successfully use rainy day funds and similar devices to smooth the impact of economic fluctuations, the growth would be a smooth 7% a year.

The Ratchet Effect

The graph shows that tax levels are changed significantly by the ratchet effect that occurs when strategies for shrinking or maintaining government operate over the course of business cycles. Like ratcheting devices in auto jacks and socket wrenches, these strategies hold any temporary gain, making it a starting point for the next gain.

In year two of the simulation, when growth falls to 4%, the spending forces obtain a tax increase to maintain 7% spending growth, so their line begins to diverge from the baseline. When growth rises to 10% they prevent tax cuts and then obtain another round of tax increases in the next recession. Tax rates rise in recessions and never fall. The shrinkers do the opposite. When revenues drop to 4% growth they drop the budget's growth by preventing a tax increase. When revenue growth rises to 10%, they allow spending growth of 7% and make 3% tax cuts.

In the twelfth year, the shrinking strategy would have produced a budget increase of 101%, only 80% of the increase from the baseline strategy. By ratcheting up, the expansion strategy would have produced a budget increase of 152%, 22% more than the baseline and 50% more than the ratcheting down strategy.

The basic problem for fiscal moderates in states like California and New York is that the devices to protect their options have failed. Knowing why they failed (e.g., not tried, not used enough, federal mandates, unusually severe state economic conditions) is important for future policy, but academic in the context of present choices. Assigning blame to particular individuals and political parties is inevitable, but doesn't make choices easier and may make later compromises harder.

The choices now being faced in some states look something like being asked to pick two to six (depending on the state) of the following: (1) tax increases too large to hide, (2) fiscal practices likely to reduce bond ratings, (2) layoffs, pay freezes, and unpaid days for state employees, (4) higher tuition, (5) school aid decisions inconsistent with teacher pay increases, (6) local aid cuts, causing local officials to blame legislators for spending cuts and local tax increases, (7) health care decisions incurring the wrath of doctors and hospital administrators and criticisms for depriving needy citizens of needed care, and (8) reducing standards of living for those dependent on state for income, a substantial number of whom are children.

The choices aren't made easier because legislators seeking reelection in November are being asked for on-the-record votes for policies with adverse consequences citizens will feel in the late summer and early fall. Nor are they easier because they presume legislators and governors won't achieve any of the initiatives they consider important, but will fail to keep promises made to voters and interest groups on a wide range of issues.

Under these circumstances, somebody has lots of explaining to do. Legislators and governors don't want to hear that their choices are so restricted and so unpleasant. They want full exploration of alternatives and enough public debate so that at least their supporters, if not their voters, will have some appreciation of their situation. This means time for witnesses to testify, protesters to protest, for interest groups to communicate with the grass roots, and for legislators to communicate with constituents.

Finding votes for tax increases is hard any time and harder in the many states where they will become partisan issues. Finding votes for measures that teachers, state employees, health workers, and local officials use as litmus tests for friends and enemies is no picnic either. Complicating it all is the apparent necessity to get votes for budget packages that have unusual combinations of positions -- such as asking tax increase supporters to support welfare cuts and employee pay freezes, asking opponents of higher social spending to sign up for tax increases.

As a result, the legislatures of California and New York have not followed the schedules that their governors have said must be followed. Some legislatures may this year, as last year, not finish their budget work until after the beginning of the new fiscal year.

HEALTH FINANCING UPDATE

There is much news but little new about state action on financing health care. This article highlights conclusions from past issues of **Reports** and provides updates on recent events.

Costs Rise, Federal Help Not On The Way

Non-Medicaid health costs are rising rapidly with adverse effects on firms, individuals, and state budgets. The good news, according to the survey by A. Foster Higgins & Co., is that 1991 employer health care costs didn't rise by 20% per employee as they did in the two prior years. The bad news is that large employers paid an average of $3,605 per employee, an increase of 12%. Total costs rose even faster, but employers shifted more costs to employees as deductibles, copayments, and coverage restrictions.

Federal action is unlikely this year. The President released his new plan in February, but without details on how its expensive vouchers and tax credits would be funded. It is now pending before the Congress along with dozens of other proposals, most of which are either vague on where the money comes from or are to be paid for by savings that knowledgeable observers don't expect them to produce. This means that candidates for federal office in 1992 will all be able to say they recognize the seriousness of health care financing issues and "have a plan" to deal with it. This step being completed, practically no one expects the next step, enactment of any plan.

A small industry has sprung up to summarize and compare the many different proposals for federal actions. Some comparisons are now being made on the relative elegance of the plans rather than their effects on the nation's health. For example, OMB Director Darman brags that the President's plan is "more detailed than 29 of the 31 plans that are out there."

Major State Plans On Hold, Minor Fixes Popular

The barriers to state universal health care plans are higher than ever. There are three massive restraints on state flexibility in adopting major changes in health care, such as their own version of the Canadian system or some of the play or pay plans: (1) tight state finances, (2) fear of interstate competition, and (3) large employers escaping state jurisdiction. Each restraint appears more binding this year than last year.

Tight state finances are eliminating many options. Most state-level plans require new state money for tax credits and coverage of the uninsured unemployed. These costs are rising as health costs rise and recession adds people to be covered. With deteriorating state fiscal circumstances, the potential for states to assume these costs is dropping.

Fierce competition limits costs states will impose on business. The second restraint is the fear of economic competition from employers in states not burdened with the taxes or cost of a state comprehensive plan. This fear increases with rising unemployment and increasing demands that states cut business costs to stay competitive. Despite tight finances, states are looking for ways to cut regular business taxes (Issue 4) in the name of economic development, debating reforms to Workers' Compensation to cut payroll taxes, and making concessions to keep plants open and attract the few new ones being built.

State powers to adopt universal care plans are limited. The third restraint is legal. States, except Hawaii which has an exemption for its pre-existing health plan, cannot regulate employer health plans because that regulation is preempted by the federal Employee Retirement Income Security Act. States might be able to avoid this restriction by using their taxing power. This was the legal theory of the Massachusetts plan that was adopted in the late 1980s but never implemented. However, attempts to regulate plans through taxation would, at a minimum, lead to extensive litigation on the preemption issue.

Current state regulation is based on state power over insurance. Employers avoid this regulation, such as mandated benefits, by not buying health insurance. Instead, they buy the administrative services of health insurance carriers and, in the eyes of the law, self-insure. The Higgins & Co. survey found self-insurance in 65% of the companies surveyed in 1991, up from 59% in 1990. Large employers can exempt themselves from state mandates by self-insurance because they have enough employees to spread risks. Medium and smaller employers don't.

Besides avoiding state mandates, such as required coverage of mental health, by self-insurance, companies can avoid insurance premium taxes. This makes such taxes an unrealistic way for states to finance coverage for the uninsured.

Many dramatic plans are being introduced in the states but none have been implemented. Governor Gardner devoted his entire state-of-the-state message to health issues. Saying that the people of Washington are "tired of waiting for that perpetual future called 'after the next election," he called for a comprehensive play or pay plan with the state contribution to be funded by higher taxes on insurance (auto, business, and homeowners) and on tobacco and alcoholic beverages.

Labor-oriented groups around the country have developed play or pay plans which have been introduced in many legislatures. These generally have a substantial employer payroll tax and a lesser employee payroll tax (e.g., 9% for employers and 1% for employees in the Vermont and West Virginia versions). The proposal that failed in the California Senate in late January was a Canadian-type plan with a 10% payroll tax paid entirely by employers and an added tax of 1.5% of personal taxable income.

A plan proposed by California's insurance commissioner envelopes the health care components of Workers' Compensation and auto insurance, permitting lower payroll taxes (averaging 6.7% but up to 8% for employers, 1% for employees). It drew the editorial endorsement of the New York Times (2/17) as a "model for every state," but has many local critics.

Minnesota's plan made it through the legislature (D-majority) last year but was vetoed by the governor (R) as too expensive. This year, negotiations are underway to develop a plan that can pass and be signed. The governor is said to be willing to back spending to cover the uninsured and revenue losses from income tax deductions or credits. But implementation might be set for some future year. There is general agreement that a substantial budget deficit exists and that taxes won't be raised in 1992.

Some proposals cover only specified target groups. Pennsylvania's would cover uninsured children up to age 6 in low and middle income households. The Indiana plan would have broader coverage but be limited to catastrophic costs. The governor's proposal in Delaware would be limited to poor children up to age 18.

Plans being offered as initiatives to cut health costs often consist primarily of waivers of current state mandates and cross-subsidies among the privately insured. The small business package recently offered by Florida's insurance commissioner and endorsed by Associated Industries of Florida and the Florida Chamber of Commerce is a good example. A new "basic" policy is authorized. It exempts small businesses from the state's mandatory coverages. These range from inexpensive acupuncture coverage to the expensive coverage of mental and nervous disorders. It adds requirements to prevent gaps in coverage including eliminating waiting periods when employees change jobs and blacklisting of high-risk employers.

Some state officials recognize the parallels between cross-subsidies in health insurance and cross-subsidies in other state policies. For example, Governor Ashcroft describes his Missouri plan as ending experience rating for small business health coverage. The experience rating term is used in Workers' Compensation and Unemployment Compensation where states charge higher payroll taxes to firms whose employees generate disproportionate claims. For the same reasons being argued in health insurance (coverage nearly unavailable or available only at extremely high prices) states limit experience rating for WC and UC. Another parallel is risk pooling used to provide affordable auto insurance to drivers with bad safety records.

Studies and task forces are still popular, with a new wrinkle of adopting a plan that is yet to be designed. As usual, there are many proposals that combine: (1) relatively inexpensive initiatives within the scope of current state responsibilities for Medicaid, public health, and insurance regulation and (2) studies of the larger issue of what to do about the uninsured. Studies with reports scheduled after the next election are subject to the criticisms like those made by Governor Gardner (see above) and because this option has already been used in many states. As a result, several of the proposals have specific dates for implementation of a plan yet to be fully designed. The Minnesota plan has this element. Governor Chiles' proposals for Florida also follow this model.

Medicaid Bringing More Bad News

Growing Medicaid costs are chewing up state budget flexibility and increasing pressures to raise taxes. The widely reported partisan flap at the February National Governors' Association meeting was over the timing of Governor Romer's comments to President Bush about federal policy, not the substance of his concern:

> *I have to leave today and go to Colorado and advocate a tax increase. You know why? Because Medicaid expenditures that have been put upon us by the federal government are more than our present budget can handle.*

He continued, *That means while I'm here I have an obligation to talk to the President before the press.* Not all governors agreed with that part. Not all governors were going home to propose tax increases either, nor is the Colorado legislature happy about Romer's proposals. But the legislature, like many governors, is committed (by past legislation in Colorado and some other states) to major school aid increases. Like some other states, Colorado may be able to cover Medicaid, deliver for public schools, and avoid tax increases. But the price must be paid somewhere (see higher education in this issue).

In their budget and state-of-the-state messages, governors said all kinds of nasty things about Medicaid and federal mandates. Looking at costs rising 16% a year, Hawaii's Governor Waihee talked of Medicaid as a "budgetary PacMan." Governor Thompson said Medicaid is "crowding out necessary investments" in other critical Wisconsin programs. Governor Campbell talked of a federal "Medicaid stranglehold." Referring to total state health care costs, not just Medicaid, Governor Gardner used the PacMan analogy in a USA Today (2/10) interview,

State attempts to control Medicaid costs aren't working well. Each attempted Medicaid cut brings a story of its own, many resulting in less savings than anticipated because implementation is blocked in the courts, decisionmakers back away from the changes, cost-increasing modifications are made, or implementation and thus savings are delayed. Frequently, the outcome is a combination of these results.

New York's payment for drugs is an example. New York pays pharmacies $2.60 per prescription plus 90% of the wholesale price of the drug. Determining the wholesale price is as tricky for New York as looking at the dealer's invoice is for car buyers because of discounts not in the price. New York began trying to reduce reimbursements in 1987, but was tied up in court by the pharmacists until January.

After litigation succeeded and negotiations with pharmacists failed, the state announced that lower rates were going into effect in mid-February. Pharmacists complained in every forum available. Some said they would no longer fill Medicaid prescriptions. Some legislators counseled delay so pharmacy reimbursement issues could be considered in the context of long-stalled budget negotiations, where reimbursement policies for all health care providers are a key issue. For whatever reason, the governor announced just before the scheduled implementation date that the changes would be postponed.

Medicaid Cost Controls At Work

The federal government has forced the Massachusetts Department of Public Welfare to rescind, retroactively, Medicaid regulations that could force the sale of a Medicaid recipient's house. The primary reason for the turnabout was not that the house can never be a countable asset under certain circumstances, but rather that Massachusetts regulations violated the federal regulations, which must be followed if the house is to be considered a countable asset. -- Boston Globe, January 23, 1992.

Massachusetts rules permitting families using Medicaid for nursing home costs to keep assets have been more liberal than those of many states. The subject is of such interest that the Boston Globe runs a column about it. A recent one (1/23) was titled, "Creative Use Of Annuity Can Soften Medicaid Asset Rules." It included discussion of a new book (Alexander Bove, The Medicaid Planning Handbook, Little Brown & Co., 1992). The book could have been titled how individuals can make states spend more on Medicaid. After several years of debate, the state attempted to tighten its regulations. The result appears on the bottom of page 16.

Last year, many states balanced their budgets by counting on savings in their Medicaid programs, a practice some states have been using for years. The FY 1992 returns are coming in with unimpressive results, as supplemental appropriation requests mount.

Cost Increasing Medicaid Problems Keep Appearing: New York and about 30 other states are affected by litigation over Medicaid recipients who are eligible for Medicare. States buy into the optional Medicare coverage (Part B) for expenses like physician visits. Medicare pays for 80% of these costs, patients pay the other 20%. Some states pay the other 20% for Medicaid recipients, which is what health care providers want. The other option is to leave the patient responsible. In practice this means physicians get 80% of their approved Medicare reimbursement, with a minimum payment of the lower Medicaid reimbursements. New York, one of the states not paying the 20%, lost a 2-1 federal Second Circuit Court of Appeals decision in February.

Like many complex Medicaid issues, this one is full of ironies. At one time it was apparently a federal rule that encouraged states not to pay the 20%. The plaintiff in the New York case is a public body -- the New York City Health and Hospitals Corporation.

The Second Circuit decision is not binding in other circuits, so only Connecticut, New York, and Vermont are immediately affected. Similar cases are likely in other circuits. The case could reach the U.S. Supreme Court by discretionary review of the New York case and would likely be taken by the Supreme Court if other circuits decide the case in favor of the states.

HIGHER EDUCATION STRATEGY

If we don't {raise tuition}, we have two nightmares. One is the nightmare of eroded quality. The other is the nightmare of fewer students.

This testimony of the head of the California State Universities (CSU) to a legislative committee is typical of what legislators are being told about higher education this year.

Funding Increases Unlikely

Most higher education officials are accepting the premise that they will be lucky to get any increases in state aid this year. They have considerable evidence to go on, including last year's experience, governors' budget recommendations, what legislators are telling them, and their assessments of what legislators are likely to do given the fiscal circumstances they face.

Higher Ed. Budget Changes In FY 1992, Percentages

U.S. Average	**0.7%**
California	-2.0
Colorado	3.0
Florida	-5.3
Illinois	0.6
Massachusetts	-16.2
Nebraska	4.0
New Jersey	0.0
New York*	-5.8
North Carolina	0.0
Ohio	-0.1
Oregon	4.5
Pennsylvania	6.9

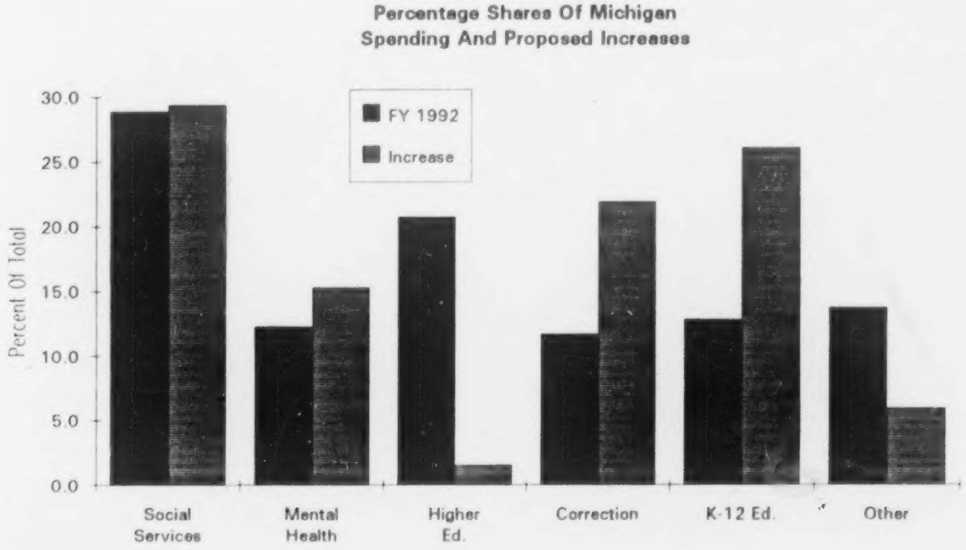
A recent survey shows that a rash of mid-FY 1992 budget cuts brought the average increase in higher education budgets to 0.7% over FY 1991, well below the inflation rate of 3-5%. The table shows budget changes.

The survey by the American Association of State Colleges and Universities found that tuition and fees increased about 13.6%. State student aid increases of 5.4% were not sufficient to cover the increases for those students receiving aid, requiring some combination of providing aid to fewer students and providing less aid per student. One question concerned the outlook for FY 1993 budgets. Only five responders felt that the situation would improve, while higher education officials in half the states thought it would be worse.

The outlook for higher education funding in FY 1993 is at least as grim as in the current year. Tax increases are under consideration in only a few states. Without them, the limited new money available is being absorbed by increasing costs of social service programs, particularly Medicaid, and corrections. Attempts to provide school aid (K-12) increases at least matching inflation are eating up the rest, sometimes more than the rest. Constrained by a fixed total and crowded out by other increases, higher education doesn't get much. This year's they-never-knew-what-hit-them award goes to higher education officials of 12 states who said in the survey that Medicaid, corrections, and other spending hadn't had a negative effect on their budgets.

In no-new-tax environments, the best place to look for significant increases in higher education funding is those states whose governors are drawing nationwide attention for cracking down on social welfare spending, California and Michigan. The new California budget contains only an 0.2% increase in general fund spending. But its proposed cuts of 10% in welfare (AFDC) and 12% in Medicaid leave room for significant increases elsewhere. Those go to K-12 education (8%) and community colleges (10%) consistent with minimum increases required by Proposition 98. Leftovers go to the University of California (1.5%), CalState (1.4%), and student aid (1.1%).

Michigan's situation is shown below. Corrections and public schools are the big gainers. Social services (including Medicaid) holds its own, but will show much larger increases through supplemental appropriations if Michigan follows past patterns. Higher education is nearly a fifth of the budget, but its share of new money is so small as to barely be visible on the graph.



Less Bucks, Less Bang

Usually implicitly, sometimes explicitly, state higher education officials are accepting the premise that their notions of what constitutes "quality" are approximately correct. Those concepts include faculty pay and teaching loads competitive with comparable institutions. From these premises, the trade-offs are inescapable:

- To maintain quality and serve the same number of students, tuition must be increased substantially.
- Without major increases in state aid or tuition, quality can only be maintained by sacrificing quantity, the number of students.

So the California State administrator told legislators that a 40% "fee" increase would still require some cuts, but would maintain the system. Without it, he said enrollment on the system's 20 campuses should be dropped to maintain quality. Such a drop would spread available state aid over fewer students, thereby enabling the system to increase per student funding -- a proxy for quality -- without increases in overall funding.

More Bang For The Buck

Legislators in California and elsewhere don't want to hear that their only choices are spending more, charging students more, or serving fewer students. Their questions run to getting more out of money already spent. Key to that discussion is the number of courses professors teach and the number of students in each course. So much money is involved in those decisions (and pay levels) that the rest is, so to speak, academic.

At CSU, individual faculty members have apparently been making their own adjustments by letting more students into courses than they have to. CSU's chancellor told the House committee that this wasn't helping the situation: "it just shows we are willing to water down quality. That's not the message we want to send."

Some California legislators are unhappy with current faculty workloads and even less happy with the reductions in teaching loads negotiated with faculty members last year. The chairman of the Higher Education Committee in the House recently commented:

> *For years, universities faced with decreasing budgets would rather get rid of students than increase faculty workload. They all want to be like Harvard and lessen the teaching load. That can't continue.*

Arizona's legislative fiscal staff took the issues to the higher education community with a commentary by one of its analysts -- "Tight Budgets Demand Studies Of Faculty Productivity" -- in the Chronicle Of Higher Education (2/19).

RESOLVING NEW YORK'S FINANCES

> *This year, "timeliness, timeliness, timeliness" should be the mantra repeated everywhere in the Capitol.*

This was Governor Cuomo's exhortation to the legislature as he presented his budget for FY 1993, which begins in April. Back in December when a large deficit in the FY 1992 budget was acknowledged, the governor urged quick action but didn't get it. Now the hope is for action before April 1, an objective last achieved in 1984.

Why Governor Cuomo Didn't Run

When Governor Cuomo was considering running for President, he consistently said that budget action or inaction and the state's fiscal situation would be the determining factor in his decision. When he decided not to run, he gave the same reason. **Reports** cannot psychoanalyze motivation, but can report that New York's fiscal situation and traditions of gubernatorial leadership in the budget processes make the governor's presence more important than in most states.

Budget Negotiations In New York

For at least a decade, New York's budget decisions have been made in summit negotiations involving the governor (D), Senate leaders (R), and House leaders (D) -- each with significantly different perspectives. These negotiations encompass most major money-related decisions including the amounts and distribution formulas for local government and school aid, revisions in state mandates, welfare payment levels and eligibility, the scope of the Medicaid program and provider reimbursement rates, university support and tuition levels, employee pay and benefits, and many details of state operations. Major financial management matters are also on the table in these sessions. They include the financing of state authorities, borrowing plans, and timing of receipts and outlays. Tax issues are always present. Even to continue tax policy unchanged, legislation is required because changes, including a reduction of personal income tax rates, are scheduled under current law.

Each of the participants carries well-publicized postures into these sessions. The Senate majority is most supportive of local aid, particularly school aid, opposed to tax increases and sometimes seeking cuts, and looking for cuts in income-tested programs and operations of state government. The House majority is strongly attuned to the financial condition of New York City, less supportive of local aid elsewhere, and more supportive of income-tested programs and state operations, including concerns of employees over pay and benefits. The governor is cast in the role of maintainer of fiscal discipline, siding with the House to avoid unrealistically high revenue estimates and unaffordable tax cuts and with the Senate to avoid steep tax increases, more extensive borrowing, and unrealistic expectations about the effectiveness of spending controls.

Choices Are Limited

The negotiations are always time-consuming and difficult and promise to be triply so this year. They are considerably more difficult than in most states because the options are more restricted.

Raising taxes isn't easy anywhere, but is harder in New York. Taxes are roughly a third above the national average, higher than any other state but Alaska, and higher than neighboring states despite the recent increases in Connecticut, New Jersey, and Pennsylvania. Business makes the usual arguments which have immensely more salience because Fairfield County, Connecticut and neighboring New Jersey areas obviously owe much of their prosperity to firms and individuals that have their economic ties with New York. Brick-and-mortar proof makes the anti-tax argument considerably more persuasive than more academic sounding arguments in states such as Florida and Texas, or even California and Minnesota. Governor Cuomo insists that the state cannot raise taxes to pay for social programs because the resulting undermining of the state's economic base would defeat its future ability to pay even for current social programs.

Dumping fiscal responsibilities on local governments isn't easy anywhere, but is harder in New York. New York City is inherently one of the jurisdictions to be dumped on. The city's taxes are very high by national standards and its fiscal problems legendary. The current generation of state decisionmakers lived through the city's fiscal crisis of the mid-1970s, which seriously threatened the economic as well as fiscal viability of the city and required a massive state bailout. State officials believe, with considerable justification, that they cannot permit New York City to develop like situations of some smaller jurisdictions elsewhere supposedly resulting from state policies -- Chelsea in Massachusetts, Bridgeport in Connecticut, East St. Louis in Illinois, and Northern California counties.

New York is either at the end of its rope or close to the end in the use of borrowing and exotic financing arrangements. This year, states like Indiana, Mississippi, Texas, and Virginia are relieving pressures on operating budgets by shifting capital outlays, like prison construction, to bond-financed capital budgets. New York did that decades ago, with a major part of the problems of the 1970s arising because operating costs had been loaded atop capital costs and financed by borrowing. On-the-books borrowing is already so substantial that the state vies (with Louisiana and Massachusetts) for the lowest state bond ratings in the nation. New York has pioneered in borrowing by state authorities, which it has in substantial numbers.

The limits of this policy were discovered in the 1980s when the state dormitory authority ran into financial difficulties. The state came to the rescue on the theory, widely supported on Wall Street, that the authorities were so integral to the state's finances that one could not be allowed to fail without undermining confidence in the state's own bonds. New York also pioneered in shifting financing even farther from its operating budget by having local governments buy or build and leasing from them. Even the buildings in which state officials discuss fiscal problems were built by others and leased to the state. Recently, the state has sold assets and leased them back, including Attica prison.

Special problems make budget cuts more complex. Many pieces of New York's public and private economies are inextricably intertwined to a much greater degree than in other states. The state runs the retirement system for jurisdictions other than New York City. It has changed retirement contribution requirements to ease the pain of state budget cuts, but then must make special arrangements for the city to provide comparable relief. Local governments cover half the costs of Medicaid, so savings in the state's budget produce parallel savings in local budgets. But when the state balances its budget based on expected savings that aren't realized, the resulting shortfalls occur in local budgets as well as the state's.

The state has a large not-for-profit sector providing children's services, health care, day care, community mental health, addiction services and more. The viability of this sector is closely tied to state budget decisions.

The contrast with other states is illustrated by bill paying in health care. Illinois has been avoiding running out of cash by delaying payments to Medicaid providers. This has produced considerable criticism as poor financial management and anguish among the providers because delayed payments are *de facto* reimbursement rate cuts. It hasn't resulted in closed facilities or much public reaction.

New York recently resorted to the same device while its officials discused possible Medicaid cuts in general terms, as is happening in nearly every state. This combination brought an estimated 20,000 people to the streets of New York in protest. On page 17 of this issue an obscure rate reimbursement issue is used as an example of judicial pressures on Medicaid costs. The dispute is between a deficit-ridden state and a deficit-ridden authority that runs public hospitals in New York City. This kind of interconnection makes cutting Medicaid much more difficult than in other states -- not because the effects on unserved patients are different or greater but because the viability of many public institutions is more closely tied to the policies and spending of other public institutions.

New York Governors As National Candidates

If Governor Cuomo were to run for President, New York finances would surely be an issue. Assessing them in a national context depends on whether the focus is on state practices or changes in state practices.

If one looks at the *changes* in state policy during his terms in office, Cuomo is in defensible shape relative to the President and many other governors, including those of Arkansas and Virginia. A recent assessment by the conservative CATO Institute compares governors' fiscal policies and concludes, "Mario Cuomo's reputation as a tax-and-spend liberal may only be half-deserved." Looking only at *changes*, proposed or enacted, Cuomo is in much better shape than Governor Clinton, who has consistently argued for a decade to raise taxes for better schools.

The vulnerability of New York governors, going back to Rockefeller, on state and local finances is on the *status* of taxes and spending, not the *changes*. The status lends itself to many unfavorable one liners. Examples: if all states had the tax levels of New York, state and local tax bills would be x% higher. If all states had as large a proportion of their population on welfare as New York, x million more Americans would be on welfare. If New York's Medicaid practices became national policy, costs would soar by $ billion. These *status* statistics immunize Governor Clinton because of the state's below average taxes and spending. He can rightfully contend that even if the Arkansas legislature had adopted every penny of his tax increase recommendations, applying Arkansas policies nationwide would reduce taxes for most Americans.

These observations have a flip side. If the test isn't low tax levels but high service levels, New York gets credit for its spending patterns and Arkansas credit for increases.

BALANCED BUDGETS AND REVENUE ESTIMATING

State officials like to contrast the federal deficit with the states, noting that 49 states have balanced budget requirements. As spring nears with state budgets not balanced, the balance requirements are getting a harder look. The requirement is typically not that the year end in balance but that balance be respected in the budget submission, the enacted budget, or both. The conclusions of Michigan's Senate Fiscal Agency are typical:

> *It appears clear that the intent of the State Constitutional [Convention] of 1963 is to ensure a balanced budget. However, and as restated from the Convention comments, "there is no apparent way of forcing a balanced budget." It also seems apparent that the Constitutional Convention delegates anticipated deficits and that, if one did occur, it was to be resolved in the ensuing fiscal year. In addition, if deficits were to occur in two or more successive fiscal years, there are no direct penalties that could be assessed or imposed.*

When major revenue estimating errors arise, as happened this year, there is considerable interest in improving the revenue estimating process. Eileen Shanahan examines state and local revenue estimating in "Cracks In The Crystal Ball" (Governing, December). The Federation of Tax Administrators has a new survey of state organizational arrangements for the revenue estimating function (Tax Administrators News, November).

There is a continuing tension between those who consider revenue estimating a technical function with results to be judged by how close estimates come to actual revenues and those who consider revenue an integral part of overall budget policymaking that also includes spending decisions, caseload estimates, and reserve funds. Deliberately conservative estimates are used in some states as hedges against errors. Deliberately generous estimates are sometimes used, particularly in late-stage legislative negotiations, to provide just a little more money to make agreement possible.

State officials are often aware of the link between revenue estimates and spending plans. Governor Cuomo provides an example. The estimates in his FY 1993 budget are based on the same pace of economic recovery assumed in the federal budget. At the press session when he released his budget, a reporter from Newsday (which serves Long Island) asked why, given past overestimates, he didn't use more conservative estimates. His response: "Because I'd have to kill your schools on Long Island and you'd crucify me."

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STATE POLICY REPORTS

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IN THIS ISSUE

State officials are blaming federal decisions for many state problems. They could have more to complain about if the pending economic stimulus proposals reduce state tax collections.

- Federal Policy And State Issues p. 2

Sharp differences in the performance of individual state economies are narrowing as recession drags high-flying states down and the Northeast bottoms out. Except for California, Western state economies are outperforming the nation's. A new assessment pinpoints how defense cuts will affect individual state economies.

- State Economic Momentum p. 6
- Impacts Of Defense Spending Changes p. 10

A new study purports to show which governors are best but may just show how fruitless such studies are. Comparing policies of states is more justifiable, but both difficult and controversial. A complex assessment of state environmental conditions and policies contrasts with a magazine's appraisal of recent "worst" state decisions..

- Evaluating Governors And State Policies p. 11
- Ten Worst Economic Moves p. 13
- Good Governors p. 14
- The Green Index p. 18

Corporate income taxes are becoming a less significant revenue source, as federal and state officials quietly alter credits and deductions without lowering rates. Pennsylvania is bucking a trend, or perhaps establishing a new one.

- Farewell Corporate Income Taxes? p. 19

Technical notes detail sources and caveats, including some of the problems of finding data by which to judge performance of governors.

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March 1992 (Second Of Two March Issues)

FEDERAL POLICY AND STATE ISSUES

Fed Bashing Remains Popular

> *It seems there is a rebellion brewing among the governors. ... It is time for states to decide, not Congress, what is a fair level of taxation for state taxpayers.*

This was one of many criticisms Governor Wilson made of federal policy when he ventured inside the Beltway (where he previously served as U.S. Senator) in late January. His criticisms were particularly pointed in a National Press Club appearance where he fielded a series of questions about California budget cutbacks by suggesting that elected officials shouldn't be in office and the people ought to throw them out if "they cannot discuss the competing claims upon the treasury of the state or the nation, if they are too damn cowardly to support the need for honest discussion of competing claims."

In his state-of-the state message, Governor Bayh compared the federal government to the British government of the 18th Century and the former government of the USSR:

> *During the last month we have witnessed one of the most remarkable events in world history. The government of the Soviet Union, bloated with bureaucracy and wildly unpopular for the abuse it inflicted on both its citizens and constituent states, was simply abolished. Their experience is not much different than our own 200 years ago. Our forbearers, tired of taxation without representation and a distant, unresponsive bureaucracy, rebelled, and America was born.*
>
> *While I don't contend that the federal government of the United States is as bad as the former Soviet Union or King George, I have a pretty good idea how Boris Yeltsin and George Washington felt.*

These comments are typical of the high levels of criticism of federal policy taking place throughout state governments. They span the political spectrum. The most immediate concerns are with federal mandates driving costs in state and local budgets and with action and inaction contributing to the recession. Officials of the states most affected by immigration -- such as California, New York, and Texas -- are concerned over administration of immigration laws and the imposition of substantial costs by the federal government without offsetting compensation for states' out-of-pocket costs. In the West, particularly Alaska and Oregon, there is concern that national rules limiting resource development are constraining state economies. In some Midwestern states, there is resentment of federal policies that appear to siphon money out of state economies for the benefit of other regions -- acid rain mandates, federal highway funds, and the savings and loan and bank bailouts.

Economic Policy And Economic Stimulus Packages

Much national attention is now devoted to the relative merits of competing Presidential and Congressional proposals to stimulate the economy. Most of the action is in tax law modifications, but there are also many proposals to increase federal spending on public works.

There is considerable partisan debate over the relative merits of the competing approaches both as tax policy and in terms of their effectiveness in causing economic recovery. While some state officials are entering the national debate, the working levels of state government are assuming that its outcome will have essentially no net impact on state finances by changing the timing and magnitude of economic recovery. The assessment by the Illinois Economic and Fiscal Commission in its Winter Update (February) is representative. It discusses possible federal action as one of many factors -- consumer spending, interest rates, exports, and more -- potentially affecting the economic outlook. It comments:

> *Federal policy in terms of taxes and spending also is likely to become more stimulative, although to what extent is unclear. Any tax cuts or spending increases are likely to be limited given the fear of generating still-larger federal budget deficits.*

The California legislative budget office has concluded that the budget submitted by Governor Wilson is now out of balance by massive amounts -- $2.8 billion this year and as much as $6 billion in FY 1993. The governor concurs that some adjustments are needed. The culprit is primarily the recession, with the timing of recovery key to how hard it will be to balance the new budget. In this context, the fiscal office doesn't mention federal economic stimulus packages as possible salvation. In its listing of downside risks, it cites two problems associated with the speed, not the substance, of possible federal action: (1) delays in federal decision on pending waiver requests affecting the state's welfare program, and (2) the risk that "delays in action on the federal budget and tax changes defer economic activity."

Somewhat ironically, the federal legislation with the most immediate potential impact on state spending simply corrects an error by which the Congress inadvertently cut highway funds for this fiscal year by $1.1 billion by authorizing work on a post office in Brooklyn and several smaller items. The complex federal budget procedures, which caused the error, mean that correcting it raises collateral issues. As a result, states are likely to put less highway construction under contract this year than state officials want or federal officials intended.

Tax Law Changes, Effects On States

Practically all of the federal tax law changes in the economic stimulus packages will have significant parallel effects on state tax policies and revenues. In general, provisions that reduce federal revenues would cut state revenues while actions to increase federal revenues would increase state revenues. Many of the packages are designed to stimulate the economy by adding purchasing power, primarily taking less out in federal taxes while either increasing federal spending or leaving it unchanged. States would benefit from whatever economic activity tax cuts stimulated but lose revenue from the changes.

The interactions of federal and state tax codes are highly complex and vary with the type of tax provision changed at the federal level and the unique characteristics of both each state's tax code and its laws and traditions in conforming to federal changes. Federal changes affecting the definitions of income (e.g., depreciation rules, treatment of Individual Retirement Accounts) are difficult for states to avoid. Federal changes affecting tax-rates, imposing surcharges, and giving special credits are more easily avoided. These and other aspects of the impact of pending federal changes are comprehensively described and assessed state-by-state in a recent publication by the state tax administrators.

Tax Law Changes, Parallel Federal And State Issues

While the dollar impacts of the federal changes under consideration are relatively small, the issues they raise, such as how to provide incentives for investment and what is fair treatment of rich and poor, are the same as those involved in much larger federal changes. This means the issues have a high philosophical content relative to their economic effects, a recipe for long debate. As a recent assessment by Goldman Sachs put it, "With little scope for increasing the size of any stimulus, the two parties appear limited to a squabble about how to distribute whatever meager changes can be made."

Many of the proposals at the federal level have parallels at the state level, particularly in those states, such as California and Wisconsin, that are relatively adventuresome in maintaining state income tax provisions deviating from federal ones. It is hard to tell whether federal officials are following state officials, state officials are following federal officials, or both are responding independently to underlying national problems and concerns. The major concepts appearing in proposals at both the federal and state level are:

> **Lower Taxes On Low-Income Wage Earners**: The concept is to cut taxes paid by those earning about what they would get in welfare payments and varying segments of the near poor. The mechanisms are higher personal exemptions, special credits or exemptions for children, and tax credits -- all designed to exclude higher income taxpayers.

Incentives For Individual Savings And Investment: The concept is to encourage investment by sheltering savings from taxes and lowering taxes on investment gains. The mechanisms are lower capital gains taxes, more flexible rules for tax-free contributions to and/or withdrawals from special retirement accounts like IRAs, and permitting individuals to participate in the same incentives as corporations.

Incentives For Business Investment: The concept is to encourage business investment and competitiveness by lowering taxes when such investments are made and/or increasing the after-tax rewards when they succeed. The mechanisms are lower capital gains taxes, a lower tax rate on corporate income, investment and R&D credits, and more liberal depreciation.

Higher Taxes On The Affluent: The concept is to make income distribution, and the sharing of tax burdens, more fair by taking a larger percentage of high incomes. The methods are a higher tax rate on incomes above about $100,000, raising the alternative minimum tax, and restricting the value of exemptions and deductions to high bracket taxpayers.

All of these concepts can be found in tax legislation introduced in the legislatures this year. Few of these measures will pass. Revenue-cutting measures, excepting some highly targeted business tax incentives for economic development, are being ruled out because states cannot afford the revenue loss. Revenue-raising measures are ruled out, at least so far, because elected officials in most states are trying to maintaining a posture of not increasing taxes this year.

The Federal Budget

In discussing their budgets, state officials are assuming that federal spending policies will remain essentially unchanged in FY 1993. This would mean that Medicaid and AFDC would grow automatically in response to increases in caseloads, prices, court decisions, and policy decisions by the individual states. The President's budget assumes this will mean federal Medicaid costs will increase by 16.4% in FY 1993, implicitly estimating that state-funded outlays will also increase by 16.4%. The likely federal spending for all other programs would show slower growth than inflation. In the President's budget, the growth for all grants to state and local government other than Medicaid would be 2.2%.

Two major policy changes recommended by the President aren't affecting state debates this year because there is considerable skepticism over whether they will be enacted and, if enacted, are not likely to take effect until after FY 1993. They are: (1) a new proposal for block grants to replace many categorical grant programs and (2) a proposed cap on Medicaid spending closely tied to the President's broader proposals for health policy.

STATE ECONOMIC MOMENTUM

Major Differences In State Economic Performance

The latest Index of State Economic Momentum (see Technical Notes for details) shows continued uneven growth in state economies.

Index Of State Economic Momentum, March 1992

Rank	State	Index	Rank	State	Index	Rank	State	Index
1	Nevada	2.39%	18	Louisiana	0.79%	35	Virginia	0.08%
2	Utah	2.17	19	Mississippi	0.78		**United States**	**0.00**
3	Nebraska	2.11	20	Wisconsin	0.72	36	Illinois	-0.04
4	Idaho	2.10	21	Kentucky	0.69	37	California	-0.07
5	Arkansas	1.92	22	Indiana	0.55	38	Pennsylvania	-0.22
6	Oregon	1.60	23	Florida	0.52	39	Missouri	-0.42
7	Hawaii	1.49	24	Oklahoma	0.51	40	Michigan	-0.56
8	Texas	1.40	25	Tennessee	0.49	41	Georgia	-0.57
9	Arizona	1.24	26	North Dakota	0.49	42	Maryland	-0.71
10	South Dakota	1.19	27	Alabama	0.48	43	Vermont	-1.00
11	Washington	1.17	28	Delaware	0.36	44	New York	-1.34
12	Colorado	1.11	29	South Carolina	0.32	45	New Jersey	-1.52
13	New Mexico	1.10	30	West Virginia	0.17	46	Connecticut	-1.55
14	Alaska	0.90	31	Iowa	0.16	47	Maine	-1.71
15	Montana	0.89	32	Wyoming	0.14	48	Rhode Island	-1.71
16	Kansas	0.80	33	North Carolina	0.13	49	New Hampshire	-1.88
17	Minnesota	0.80	34	Ohio	0.10	50	Massachusetts	-2.43

Every one of the states in the top third in economic performance is West of the Mississippi River. Thirty-five states beat the national average, which is set as the Index benchmark of 0.00%. This occurs because growth is concentrated in smaller states while larger ones like California, Georgia, New York, and Pennsylvania have been turning in sub-par performance. Reflecting recession, the national average itself is sub-par, so states in the bottom third of the table are running at the back of the pack in a slow race.

It is extremely difficult for any state to outperform the national averages consistently. States which do, as New England did several years ago, can easily crash to the bottom, as those states have done. Good times tend to lead to overheating and eventual declines. This appears to be happening to Nevada now, as it did to Arizona before it. While first, Nevada's margin over other states is much less than in the Index when it was last published (Issue 24 of 1991). Resource-reliant states like Oklahoma and West Virginia hit bottom in the 1980s and now are ahead of the national pace. Every one of the eight lowest states on the table is closer to the national average than it was in the December 1991 Index.

Employment Change

The United States lost about 830,000 jobs from December of 1990 to December of 1991, a decline of 0.76% compared with an increase of around 1.5% that should prove to be about the annual growth rate for the 1990s. The job loss was highly concentrated in a few industrial states -- 267,200 in New York, 149,500 in California, 138,300 in Massachusetts, 95,200 in New Jersey, 70,900 in Georgia, and 64,000 in Connecticut. Twenty-six states, mostly less populous Western states, gained jobs. The percentage changes are shown in the table.

Percentage Change In Employment, December 1990 And 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nebraska	4.05%	18	Arizona	0.74%	35	Washington	-0.73%
2	South Dakota	3.53	19	West Virginia	0.60		**United States**	**-0.76**
3	Arkansas	3.46	20	Indiana	0.60	36	Florida	-0.79
4	Idaho	2.60	21	Kentucky	0.55	37	Pennsylvania	-0.88
5	Utah	2.13	22	New Mexico	0.46	38	California	-1.15
6	Alaska	1.67	23	Oklahoma	0.38	39	Michigan	-1.52
7	North Dakota	1.56	24	Iowa	0.27	40	Missouri	-1.96
8	Oregon	1.38	25	Nevada	0.25	41	Rhode Island	-2.23
9	Kansas	1.21	26	Wyoming	0.10	42	Vermont	-2.29
10	Montana	1.10	27	South Carolina	-0.01	43	Georgia	-2.35
11	Colorado	1.09	28	Ohio	-0.06	44	Maryland	-2.36
12	Texas	0.95	29	Illinois	-0.30	45	New Jersey	-2.60
13	Hawaii	0.91	30	Delaware	-0.32	46	Maine	-3.17
14	Mississippi	0.88	31	Tennessee	-0.40	47	New Hampshire	-3.18
15	Louisiana	0.84	32	Alabama	-0.43	48	New York	-3.26
16	Minnesota	0.75	33	North Carolina	-0.47	49	Connecticut	-3.87
17	Wisconsin	0.75	34	Virginia	-0.65	50	Massachusetts	-4.68

The top five states are the current economic success stories. All can point with pride to success stories in the private sector -- software companies in Idaho and Utah, Wal-Mart in Arkansas, telemarketing and credit card operations in South Dakota, and ConAgra in Nebraska. In all of these five, state officials can (and do) claim they have pursued policies to create an environment for this successful entrepreneurship. In Nebraska and South Dakota, specific changes in state policy -- taxes in Nebraska and regulation and taxes in South Dakota -- were made to encourage the development that has now materialized.

New England states dominate the bottom of the list with other Eastern states -- Georgia, Maryland, New Jersey, and New York -- interspersed. The award for winning by not losing goes to the Industrial Midwest with states close to the national average. In most recessions, these states, with their emphasis on manufacturing, do worse than average.

Personal Income Growth

During the quarter ended last September (latest data available), personal income grew by 2.8% nationally from the same quarter of 1990. The increase is less than the rate of inflation in the same period, reflecting a decline in purchasing power as the recession's impacts appear. The state-by-state changes shown in the table are a good indicator of where the recession has been felt the most.

Percentage Growth In Personal Income, Third Quarter, 1990 And 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Utah	6.2%	18	Oklahoma	4.1%	34	Florida	2.8%
2	Hawaii	5.2	19	Nevada	4.0	34	Illinois	2.8
2	Idaho	5.2	19	Wyoming	4.0	34	Iowa	2.8
4	Louisiana	5.1	21	Kansas	3.8	37	North Carolina	2.7
5	Texas	5.0	21	North Dakota	3.8	38	Virginia	2.6
6	Arkansas	4.9	23	Minnesota	3.6	39	Georgia	2.4
6	Nebraska	4.9	24	Indiana	3.5	40	Michigan	2.2
6	New Mexico	4.9	24	West Virginia	3.5	41	California	1.9
9	Arizona	4.6	24	Wisconsin	3.5	41	Connecticut	1.9
10	Colorado	4.5	27	Alaska	3.3	41	Maryland	1.9
10	Montana	4.5	28	Missouri	3.1	41	New York	1.9
10	Washington	4.5	29	Delaware	3.0	45	Vermont	1.2
13	Alabama	4.4	29	Ohio	3.0	46	New Jersey	0.8
13	Oregon	4.4	29	South Dakota	3.0	47	Maine	0.2
15	Mississippi	4.3	32	Pennsylvania	2.9	47	Massachusetts	0.2
16	Tennessee	4.2	32	South Carolina	2.9	49	New Hampshire	0.0
17	Kentucky	4.1		**United States**	**2.8**	50	Rhode Island	-0.3

The rankings are similar to those for job growth on the preceding page, with Northeastern states and California on the bottom and Western states on top. There are differences, particularly among the top ranked states, because personal income reflects income not captured by the jobs data -- income from farms and other proprietorships, wage and salary changes not caused by job loss and gains (e.g., raises and overtime), and transfer payments such as Social Security benefits.

Farm Economy Prospering

The prosperity of the farm economy is one of the major reasons why states West of the Mississippi River haven't been experiencing the economic problems found in the Northeast. A recent Department of Agriculture report provides the details. Overall the report concludes that the performance of the farm economy "compares favorably with its best performances over the last several decades."

Good times on the farm are good news for state finances. First, there is now little interest in state farm aid programs that were discussed -- and to a limited degree enacted -- in Midwestern states in the mid-1980s. The exception is difficult times being experienced in the dairy industry which have caused state subsidies to be considered in several states and enacted on a limited basis in Vermont. Second, farm prosperity brings high farmland prices and increased business activity in rural areas, improving the base for state and local taxes.

The Department keeps statistics by state on farm equity (value minus debt) and makes calculations on equity per farm and equity per acre. According to these estimates, buying out all the farm operations in the U.S. would take about $700 billion with the largest amounts in Texas ($65 billion), California ($58 billion), and Illinois ($41 billion). The value, net of debt, of the average farm in the U.S. is $326,000. The range is from over $1,000,000 per farm in Arizona and Nevada to $110,000 in West Virginia. By the acre, farms (including equipment as well as land) are worth the most in the Northeast, led by $8,484 in New Jersey. The lowest per-acre values are associated with arid lands in the West with values under $300 an acre in Wyoming, New Mexico, Montana, and Arizona.

Economic Performance And Fiscal Problems

In normal times, the Index of State Economic Momentum is a reasonably good indicator of which states are likely to be experiencing fiscal problems or successes. In recession, this is less true. To find themselves in reasonably good fiscal shape because of a strong economy, states would not only have to exceed national performance but exceed it by a substantial margin. With over 30 states now reporting their current year (FY 1992) budgets out of balance, it isn't surprising to find that some top ranked states in the Index have problems, though by no means as serious as those of states in the bottom ranks.

Among the top ten states, only four -- **Arkansas**, **Idaho**, **Utah**, and **South Dakota** --have stable fiscal policies including paying for about the current levels of state services and state aid for local government, meeting inflation with spending increases, and not making major changes in taxes. **Hawaii** is in equally good shape, but the level of local worry is higher because prosperity appears as a decline when the psychological starting point is a boom.

The other five have problems of their own making. In **Nevada**, the problem is a tax system designed around gambling that is proving inadequate, except in the biggest of economic booms, to handle the service needs of a rapidly growing population. In **Arizona**, the problems are: (1) particularly serious escalation in health costs as the state moves closer to traditional Medicaid programs and (2) budget-balancing decisions in previous years that are now bringing problems. In **Oregon**, the problem is a voter-imposed limit on local property taxes with a mandate that the state make up lost revenue. In **Texas**, the problem is a court decision holding the school finance system unconstitutional. **Nebraska**'s problem also arises from litigation, but over the taxation of personal property.

IMPACTS OF DEFENSE SPENDING CHANGES

Defense Spending Cuts

The disintegration of the Soviet Union and Operation Desert Storm have altered views of the necessary level of defense spending. The disintegration means the perceived #1 threat is less menacing. The success showed the weapons and the readiness and skills of U. S. forces were better relative to the competition than had been assumed. The result is a national consensus that defense spending should be reduced. Changes are already underway, presaging major shifts in the composition as well as the level of spending. They will have significant and differing effects on state economies. State officials are trying to assess these effects and consider what actions, if any, they should be taking.

At a minimum, outlays for defense are likely to be reduced in conformity with the plan submitted by the Bush Administration in early 1991. Inflation-adjusted outlays would drop 20% between 1991 and 1997. Defense spending would continue the decline from 6.4% of gross national product in 1987 to 5.5% in 1990, reaching 3.6% in 1997. Many national leaders are urging a more rapid decline, such as one reflected in economic stimulus legislation that recently passed in the U.S. House of Representatives.

Economic Effects Of The Cuts

The economic effects are obviously dependent upon the size of the cuts and, less obviously, on the characteristics of the reductions. The Administration's reductions have across-the-board effects on all types of forces (strategic and tactical, active and reserve, air, naval, and ground) and on all types of spending (research, weapons buying, pay of personnel). Alternative strategies involve more significant changes, such as a smaller more mobile force, with more spending on some capabilities, such as sea transport, and less on others, such as maintaining Army divisions and Navy carrier groups. Cuts below the Administration's recommended program could take many forms, but appear to be focused primarily on procurement.

Winning And Losing States

A new Congressional Budget Office study of the cuts shows that the overall economic effects depend on how the savings are used. The cuts alone will result in the loss of an estimated 1.1 million jobs in 1995 -- 400,000 in defense jobs in private industry, 200,000 in supplying defense contractors, 360,000 less uniformed military personnel and 130,000 less defense civilian employees. Some states would be more affected than others. In the simulation done by CBO, the most serious negative effects are concentrated in Alaska, Hawaii, Mississippi, Maryland, New Mexico, South Carolina, Virginia, and Washington -- with Connecticut and Kansas close runners-up.

Larger industrial states with heavy defense business -- such as California, Massachusetts, and Missouri -- would suffer lower percentage impacts because their large losses would be mostly offset by large gains in civilian activities. Other states with low reliance on defense, particularly states in the Midwest, would be net gainers depending on the scenario used to measure impact (see Technical Notes).

State Action

Officials of some states are active in efforts in the Congress to make sure defense cuts affect someone else by retaining defense contracts for in-state firms and preventing base closings. Officials of all affected states are involved in assessing the impacts of changes and working with local and defense officials to mitigate clearly identifiable adverse impacts such as those associated with base closings and loss of major orders by defense-oriented firms. Even New Hampshire, which has been more resistant to aiding particular firms and localities for economic development than other states, will pitch in to deal with the effects of an air base closing if the governor's recommendations are adopted.

The impacts on local areas vary tremendously as illustrated in the CBO analysis by special studies of closing Fort Ord (California) and Bath Iron Works (Maine) and loss of much of the substantial defense business in the St. Louis area. The worst problems arise when workers, such as shipyard workers in Maine, aren't likely to be able to find comparable jobs. The least problems arise in diversified economies like St. Louis and in areas like Monterey where the outlook for the private economy is strong.

EVALUATING GOVERNORS AND STATE POLICIES

As the national and state political "high season" nears, the demand for shorthand ways to evaluate the performance of state officials escalates. The already high level of activity becomes a crescendo of gradings, ratings, and supposedly objective assessments.

Standard Comparisons

Comparisons of states are always popular. Many are based on a single measurement such as sales tax rates, welfare payment levels, and per capita income. Twice a year the latest data for these appear in States In Profile. Some comparisons involve complex calculations. Examples are calculating the tax consequences for a hypothetical business opening a plant in each of several states and comparing the regressiveness of tax systems of different states. These comparisons, which are reviewed constantly in **Reports** as they appear, are less well established because they involve expensive work and raise technical issues. But with appropriate caveats, they are widely accepted. That is, accepted in the sense that there is little quarrel about the accuracy of the data. The value judgments -- such as whether it is better to have low or high business taxes -- are clear, though controversial.

Elaborate, But Common, Comparisons

More adventuresome comparisons combine different indicators. Examples are the Index of State Economic Momentum in this issue, comparisons of health using mortality and morbidity data, comparisons of living costs, and comparisons of educational attainment of children in school. All of these reflect judgments about what is how important. In comparing education, should standard tests give equal weight to student's math and verbal scores and no weight to composition? In measuring health, should one premature birth be equated to two suicides, or just one?

All of these composites are flawed in the sense that a second researcher wouldn't necessarily produce the same comparisons as the first, unlike two researchers comparing tax rates who should get the same answers. However, the different answers would arise from disclosed differences in the choice of emphasis -- for example, how much state minimum wage laws affect business location decisions. The competent composite comparisons do pass an important test for any reputable research, being suitable for replication. That is, given the methodology, a second researcher should be able to reproduce the results.

Comparisons Concealing Policy Prescriptions

These comparisons don't tell what many people really want to know: Are taxes too high in California? Is Massachusetts a good place to grow a business, or a family? Is Michigan unfair to the poor, or uncaring about the environment?

To answer questions like these, many comparisons combine comparative statistics with judgments about appropriate policy. Conceptually, this isn't hard. A table comparing welfare payments can become a study of welfare havens or states that neglect the poor, just by renaming the statistics. Using ten statistics rather than one, printing a report with lots of footnotes, and giving the result a catchy title, like the "Green Index," or best-governed states in America, adds to the free-publicity, but doesn't improve the basic concept.

Comparisons Of Elected Officials

Even comparisons of states don't always tell people what they want to know: Does Governor Clinton have a good record in Arkansas? Should my governor be reelected?

Evaluating performance *of a state* is much different from evaluating performance *of state government*. Climate is a perfect illustration. Everyone knows better than to hold state governments responsible for climate as used in studies of the best place to retire. But an annual study of business climate includes many factors nearly as far beyond state government control as the weather. After years of criticism for not recognizing this, that study now distinguishes between factors decided by government and those which are not.

Bad outcomes -- premature births, felonies, welfare dependency -- are the product of many factors, of which state government policy is certainly one. So, arguably, *state officials as a class* could be held accountable. This is much different from evaluating performance of *a particular state official, such as the current governor*. The "Massachusetts Miracle" was a good example of this two step fallacy. The first step was to attribute economic prosperity to state government action. The second was to attribute the state government action to a particular official, Governor Dukakis, who shared power with other officials, like legislators and mayors, for part of the time the presumably good policies were in effect.

Three recent comparisons are indicative of what will be a flood of such activity before November. The first is a magazine article scathing in its review of the "ten worst" economic moves by state and local government. The second is a study identifying "good governors." The third is the "Green Index" showing which states have the best environments and environmental policies.

TEN WORST ECONOMIC MOVES

> *...a series of wrongheaded and shortsighted decisions that could exacerbate the longest recession since the Great Depression of the 1930s. Excessive expenditures have been concealed in complicated footnotes to budget documents, for example, additional taxes have been heaped upon the nation's struggling poor, jobs have been purchased at exorbitant prices, and all-important business growth has been snuffed out by ill-conceived fiscal legislation.*

With this stirring introduction, U.S. News & World Report (1/27) begins an assessment of ten state and local fiscal decisions it considers so wrongheaded that national leaders should examine them to study what *not* to do. While written to show clear error in decisions, the article is based on conclusions by the magazine about appropriate state policies. Those policies (and the primary offenders) are:

Tax Policy: States shouldn't concentrate tax increases on business (Pennsylvania), nor have a corporate income tax rate above 10% (Pennsylvania). They shouldn't tax business services when doing so might cause moves to other states (computer and other services in Pennsylvania, telecommunications in Illinois). States shouldn't raise sales taxes (North Carolina) because they are regressive and provide less dependable revenues than personal income taxes. States exempting food from sales taxes shouldn't define some foods (snack foods in California) as taxable because of administrative costs and difficulty in defining what should be taxed and what shouldn't.

Limiting property taxes (Oregon's 1% initiative) is also a mistake. States shouldn't let local governments require housing developers to cover costs of new schools and other infrastructure. Even when permitted to levy "impact fees," local governments should avoid them, particularly if their housing market is soft (Montgomery County, Maryland).

Financial Management: States shouldn't balance budgets by: (1) selling assets and leasing them back (a prison in New York, a highway in New Jersey), (2) paying bills late (Illinois), (3) accelerating revenues by requiring vendors to remit taxes more quickly (Illinois), (4) delaying scheduled payments to local governments (many states), or (5) adopting Medicaid bootstrap financing plans (Illinois), particularly when they know the federal government is about to disallow the strategy. States shouldn't allow cities to declare bankruptcy and cities (Bridgeport, Connecticut) shouldn't do it. States shouldn't adopt major tax increases and then create an unstable business climate by serious attempts at repealing them (New Jersey), at least not if it looks as though the money is needed.

Economic Development: Government shouldn't buy jobs (Arlington and the State of Texas for GM), particularly not at prices like $69,000 a job (Indiana for United Airlines), and certainly not at $130,000 per job using junk bond financing (Minnesota for Northwest Airlines).

Assessing "Worst" Policies: These assessments of "worst moves" are just opinions with examples. They often implicitly endorse policies their authors wouldn't. For example, rejecting sales and business taxes, as U.S. News does, suggests endorsing higher personal income and property taxes. There are no criteria used to determine which policies are included or excluded from the list of ten, or to determine whether the appropriate list contains ten policies, rather than nine or eleven. The summary assessments lack any appraisal of the arguments for and against the policy, like the complex considerations of the corporate income tax rate decision in Pennsylvania discussed in detail in this issue.

GOOD GOVERNORS

An objective fiscal policy index was devised and used to determine which governors have raised spending and taxes the most and which the least. The results give a clear indication of the fiscal responsibility of each governor.

With these words, CATO Institute's director of fiscal policy studies introduced his 86-page assessment of America's governors. A short version appeared as "The Good Governor Guide" in the Wall Street Journal (2/5). Both versions have precise ratings with school-like letter grades and scores ranging from 25 to 85. These rankings will unquestionably be heavily used by high-ranked governors seeking reelection in November and by opponents of low-ranked governors who are seeking reelection -- "REELECT SMITH -- Ranked As Top Governor by Wall Street Journal."

The rankings seek to distinguish the big spenders and taxers from governors practicing "fiscal restraint." The author says the purpose "is to determine which governors have raised spending the most, and which the least." The rankings are based on the judgment that low spending is good. But, if the methodology and data are sound, the rankings could be reversed to show which governors best meet needs for spending.

The rankings have serious conceptual flaws aggravated by problems in implementing the concepts. Even for those who equate low spending and low taxes with good government, the "Good Governor Guide" isn't a good guide.

Examining The Results: The table selectively illustrates the rankings. Five governors were excluded, so Governors Florio and Waihee tie for the worst possible score.

Some of these rankings "look right" in the sense that they conform to national publicity. Governors Weld, Engler, and Thompson have received national publicity for budget cutting and particularly for attacks on welfare spending. In the Democratic Presidential nomination race, Governor Wilder boasted a no-new-tax stance and Governor Clinton points with pride to a record of spending more to improve schools.

CATO Rankings Of Governors' Fiscal Policies

Rank	Governor	Party	State	Score	Grade
1	Weld	R	Massachusetts	85	A
2	Sullivan	D	Wyoming	75	A
3	Engler	R	Michigan	73	B
5	Wilder	D	Virginia	69	B
6	Bayh	D	Indiana	68	B
10	Romer	D	Colorado	67	B
11	Thompson	R	Wisconsin	64	B
12	McWherter	D	Tennessee	62	B
16	Casey	D	Pennsylvania	58	C-
19	Edgar	R	Illinois	57	C
23	Voinovich	R	Ohio	56	C
25	Schaefer	D	Maryland	55	C
26	Carlson	R	Minnesota	54	C
27	Cuomo	D	New York	54	C
29	Richards	D	Texas	54	C
31	Andrus	D	Idaho	51	D
34	Clinton	D	Arkansas	49	D
36	Branstad	R	Iowa	46	D
42	Wilson	R	California	32	F
43	Weicker	I	Connecticut	27	F
44	Florio	D	New Jersey	25	F
44	Waihee	D	Hawaii	25	F

The tax-raising efforts of Governors Florio and Weicker are well known. Governor Wilson is paired with President Bush by conservative critics as examples of leaders selling out to the tax and spend crowd.

Some of the rankings don't "look right." The #2 governor is one of fewer than ten governors advocating tax increases this year. The #10 governor recently made headlines by confronting the President with the complaint that federal policies were forcing tax increases for his state. Tennessee's #12 governor has been advocating an income tax and recently signed a sales tax increase. Governor Casey places in the top third despite advocating and securing enactment of the nation's largest state tax increase last year. Governor Schaefer (#25) has consistently pushed higher spending and, for the last two years, higher taxes. Governor Branstad (#36) has been fairly consistent in opposing higher taxes.

Besides not totally corresponding to governors' records in advocating higher taxes, the rankings don't correspond to assessments of fiscal management inherent in bond ratings. The three worst states by this measure of fiscal management are Louisiana, whose governor wasn't ranked, New York whose governor is ranked in the middle of the pack, and Massachusetts, whose governor is given the top ranking in the nation.

Evaluating The Study's Methods: As an evaluation of *people* who serve as governor, the study has intrinsic error because the data deal only with the policy decisions and fiscal circumstances of *state governments*. Not recognizing the difference leads to some clear fallacies. By the study's methodology:

Governors get credit for frugality forced on them by legislatures and voters. Governor Sinner gets credit for fiscal restraint because a major tax increase he supported was taken to referendum and rejected by North Dakota voters. Governor Finney gets no blame for recommending what would have been one of the nation's largest tax increases had it not been rejected by the Kansas legislature.

Governors get credit or blame for the actions of their predecessors. Not many current governors came into office with sound fiscal situations bequeathed by their predecessors and their legislators. Exceptions were Governors Walters of Oklahoma (#4), Bayh of Indiana ((#6), Finney of Kansas (#7), and Nelson of Nebraska (#28). They were (although they would dispute this to varying degrees) handed substantial reserve funds, balanced current service spending and taxing patterns, or both. They look good in the CATO rankings.

Some governors who look bad in the rankings were handed the reverse -- low or negative reserves, special unsolved problems like financial institutions in Rhode Island and unbalanced current service budgets -- all exacerbated by recession. Two governors who handed themselves these problems, Casey of Pennsylvania (#16) and McKernan of Maine (#18), look reasonably good in the rankings because CATO gives them credit for good times as well as blame for the bad. Two governors who inherited what everyone in their states saw as a fiscal mess and more or less corrected it, Sundlun of Rhode Island (#39) and Caperton of West Virginia (#40), get bad marks. In the less clear-cut cases of inheriting fiscal problems, three prominent tax-raising governors -- Wilson of California (#42), Weicker of Connecticut (#43), and Florio of New Jersey (#45) -- also contend that they inherited many of the problems causing large tax increases.

Governors get credit or blame for their economic circumstances. The CATO methodology creates interesting results in a booming economy. To the extent that spending follows the economy down or up without tax changes, governors get credit or blame. So Hawaii's boom costs Governor Waihee who ties for last. But New England's contractions help Governor Gregg (#9) despite his association with tax increases.

The problem of crediting governors when state economies falter was noted by Peter Howe who covers Bay State finances for the Boston Globe (2/6). He asked Stephen Moore (CATO) to explain the study's reference to a tax cut of $1,316 for a family of four:

> *Asked over the phone whether Weld had somehow slipped through a huge tax cut last year that no one in the Bay State had noticed, Moore admitted that his $1,316 number represented the decline in total general-fund tax revenues per family during 1991. In other words, when 200,000 people lose their jobs and businesses go bankrupt in record numbers, we should be impressed when the state's total tax take drops.*

The flip side of this problem appeared in Idaho where the booming economy has permitted rapid spending growth with no tax increases. Responding to a grade of D for Governor Andrus, his press secretary gave CATO an F for analysis.

Can This Methodology Be Saved? These problems are inherent in any methodology that ascribes to governors results caused by a state's economy and/or decisions of other political actors. For example, by most techniques of measuring tax burdens, Governor Dukakis gets credit for lowering taxes more than practically any governor in the nation in the mid-1980s. Most other New England governors would also look great. But Oil Patch governors of the 1980s, like Clements of Texas, would appear poor fiscal managers. If spending, not taxes, is the key, then governors take the blame and credit for higher spending associated with rapidly growing and contracting economies. These results are most absurd in the case of Alaska -- excluded "because of peculiarities in its budget and tax policies." The peculiarities are in the CATO measurement, not in the states. They also appear in another resource-rich state, Wyoming, whose governor gets the second highest rank.

These problems would appear in any attempt to do what CATO did, regardless of: (1) who did the work, (2) whether they consider more spending and taxes good or bad, (3) the variables chosen, and (4) how carefully they did the research. CATO's work also has problems of CATO's own making (see Technical Notes). The net effect of conceptual and technical problems is that the ranking doesn't achieve what might be hoped of it. For example, if campaign contributors who want to further a philosophy of cutting state taxes put their money on all the high-ranked governors and no low-ranked ones, they will make what **Reports** would have to call mistakes.

Yesterday's Heroes? What happens to governors ranked tops? David Osborne, whose new book is getting national attention (Issue 4), published Laboratories Of Democracy in 1988 glorifying six governors as a "new breed of governor" who "create models for national growth." Three failed in bids for other office -- Babbitt and Dukakis for the Presidency and Thornburgh the Senate. Governor Blanchard was defeated in his reelection try. The other two -- Governors Clinton and Cuomo -- are still in office.

Scholarly Approaches To Evaluating Governors: There is substantial academic literature on what is known as the "determinants" of state policy. The concept starts with policies to be explained, such as the level of taxes and spending or the extent to which states have liberal social programs as indicated by such measures as welfare payment levels. The research is to find characteristics of the states that are associated statistically with the policies. Some of the relationships are strong, such as the tendency of states with high per capita incomes to spend more per capita. The hard part of the research is to hold these relationships constant and see whether the remaining variation is associated with other factors such as which political party is dominant, how strong the governor's powers are, and features of the population such as age, religion, and attitudes. Individual political actors, such as governors, are never a factor in this type of research.

A recent book, Gubernatorial Leadership And State Policy, explores the state of the art in academic assessments of governors. In its summary chapter, David Gross (University of Kentucky) concludes, "The question of who or what is more powerful or successful, therefore, may simply not have a readily apparent answer that can be considered theoretically satisfying."

THE GREEN INDEX

The Green Index is to the environment what business climate studies are to the economy. The book-length study uses 256 variables to produce an index of "overall environmental health." Oregon ranks first, followed by Maine, Vermont, and California. Southern states have the worst rankings, followed by the Midwest. A subsidiary index uses 179 of the indicators to measure "Green Conditions" which are best in Hawaii and Vermont, and worst in Texas, Indiana, and Louisiana. The other 77 variables assess "Green Policies." The policymakers of California, Oregon, and New Jersey are the winners. Arkansas has the worst policies, followed by Alabama and South Dakota.

Most of the 179 environmental conditions aren't under control of state officials. For example, states without much water don't have much water pollution. States without much agriculture don't have much agricultural pollution. Some states have more federal land than others. State averages often deal with geography, not people, so pure air in much of Colorado doesn't mean Denver is smog free. A state can improve its "fun and life quality" rank by population loss, but decisionmakers usually don't want to pay this price.

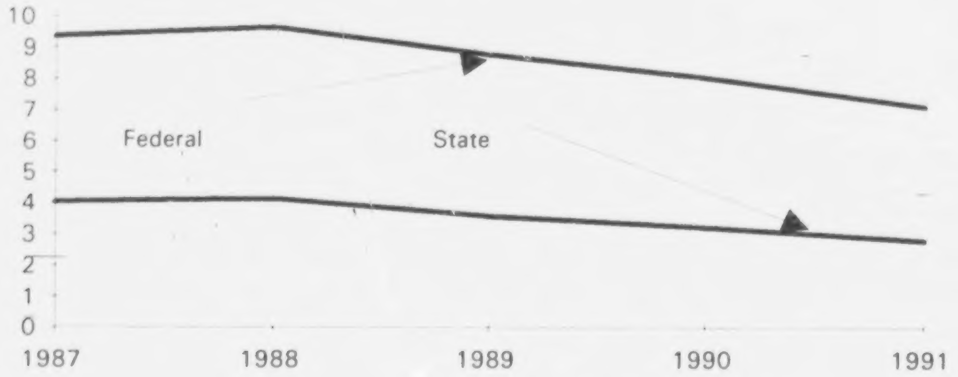
The "green policies" appear to be a reasonably comprehensive listing of state policies backed by most environmentalists. This makes the index useful for some purposes. Although its authors feel as strongly about environmental policies as the CATO author feels about fiscal policies, the study doesn't purport to rank governors, as distinct from state governments.

FAREWELL CORPORATE INCOME TAXES?

Income taxes on corporations appear to be one of the casualties of the economic competition among states, although not all states are pursuing parallel policies.

Taxes on corporate income are becoming an increasingly less important provider of revenues for both federal and state governments as shown below. Corporate income taxes represented about 2.8% of state and local receipts in CY 1991, down from 4% as recently as 1987. Part of the decline is associated with the recession, but it was appearing well before the recession began.

Percentage Of Receipts
From Corporate Income Taxes



State corporate tax collections also have been declining slightly as a percentage of federal ones, with a drop from 28% in 1987 to 27% in 1991. This movement is the opposite of what would be expected as there has been no change in the federal rate during that period while several states have raised their corporate rates. So the percentage should be moving up, not down.

Cutting The Corporate Tax Quietly

These data confirm trends that are apparent in state actions on corporate taxes in the last several years and proposals pending in many legislatures. In difficult fiscal and economic times, there has been little interest in cutting the tax rate paid by corporations but considerable interest in cutting the taxes paid by corporations without cutting the rate. The rationale is that targeted corporate tax breaks will stimulate state economies.

The targets vary. A common one is employment expansion, with credits provided for each job added beyond a baseline. The popular research and development credit works the same way, but the baseline is research and development spending. State investment credits are also common. Some of the targeting is place-specific, such as enterprise zone exemptions. Some is firm-specific, designed as part of a package to lure a particular firm.

Another approach is to reduce the amount of a corporation's income that is attributed to the taxing state. The traditional approach allocates income proportional to percentages of property, sales, and payroll in the taxing state. On this basis, a firm selling internationally from a production base solely in one state would have about two-thirds of its income taxed by that state. By moving to other allocation methods, states have reduced taxes of in-state firms. For example, by allocating income solely on the basis of where sales are made, as Iowa has done, the tax of such a firm would be applied to less than 5% of income not two-thirds. With no rate reduction, this is a 90% tax cut for such a corporation.

Why Cut The Corporate Tax?

There is little evidence that lower corporate income taxes spur state economic development. But many state officials believe that anything that cuts the costs of firms must have some favorable impact on development. There is evidence from surveys of corporate leaders and from testimony of corporate officials in state legislatures that corporate rates provide a psychological signal about state attitudes toward business even though other decisions (e.g., Workers' Compensation, Unemployment Compensation, environmental rules, and property taxes) may have more significant effects on the corporate bottom line.

Corporate income taxes aren't favorites of economists who study tax policy and thus not of legislative staff members who follow their thinking. Picking a public finance textbook at random (Harvey Rosen, Public Finance) yielded a discussion suggesting that who bears the burden of the tax is unknown. It may be workers, not owners, as capital is more able to move among states than labor. The latest book-length state tax study (Robert Ebel, ed., A Fiscal Agenda For Nevada) didn't recommend a particular tax, but seemed no more interested in a corporate income tax than a value added tax or a franchise tax based on corporate worth. It did recommend that any new business tax be applied to corporate and non-corporate business, a criterion which a corporate income tax can't fulfil.

Corporate income taxes are a less reliable source of revenue than other major taxes. Revenues are worst in recession, just when money is needed the most. In the six months ending in December compared to a the same six months a year earlier, the latest report from the Center for the Study of the States shows revenue growth of 6.7% in personal income taxes, 5.7% in all taxes, and 4.9% in sales taxes, but only 0.7% in corporate income taxes despite some rate increases. Revenues are also unpredictable. In the six months, revenues went up by 37% in Arizona, 32% in Oklahoma, and 74% in Rhode Island. They dropped by 71% in Hawaii, 38% in Louisiana, and 47% in Maine.

The Politics Of Corporate Income Taxes

In the politics of state taxation, there has often been a distinction between "liberals" who want tax burdens to fall on business and "conservatives" who favor taxes on individuals. This distinction appears to have blurred in the states and nationally.

The clear thrust of those who are concerned that the rich have too much and the poor too little is to support increasing the top bracket rates of the personal income tax while reducing income taxes on poor persons, avoiding sales taxes, and offsetting sales tax regressiveness with income tax credits. Liberals and conservatives alike are proposing business tax changes such as investment and R&D credits. A noteworthy development occurred this year when the Democratic members of the U. S. House Ways and Means Committee endorsed both: (1) a list of corporate tax breaks and (2) a cut in the corporate rate. Other House Democrats balked at the rate cut, though not at other concessions.

At the state level, action by two states last year brackets the contrasts. Pennsylvania increased its corporate income tax substantially while Connecticut enacted a new personal income tax as part of a package including substantial business tax relief from lowering its corporate income rate. The prevailing approach in states raising taxes was either: (1) raising personal but not business taxes or (2) raising business and personal taxes together approximately maintaining the previous relative reliance on the two.

While those are the types of changes the public is seeing, incremental changes are being made in many states, even in recession, that chip away at the yield of the corporate income tax without changing the apparent rate at which corporations are taxed. In some sense, this gives elected officials the best of two worlds. They conform to public opinion, which clearly favors taxing business over taxing individuals. They simultaneously conform to business pressures for tax reduction and economic development considerations by lowering business taxes. This works, but has risks. One risk is that some business decisionmakers will use the corporate rate, not actual tax burdens, as a measure of state business climate. Another is that actions to reduce business burdens at the expense of taxes directly falling on individuals will be detected and become political issues.

Pennsylvania's Increase In Business Taxes

Last year Pennsylvania raised its corporate income tax rate to 12.25% and applied its sales tax to some business-to-business services. The consequence -- "A Painful Bite For Business" as U.S. News called it (see p. 13) -- was clearly a business concern and arguably the beginning of an exodus of business from the state and unemployment in the affected industries. Pennsylvania was bucking the conventional wisdom by getting a high proportion of its new revenue from business, an action that will be more pronounced if the personal income tax increase is rolled back in July as scheduled.

Its increase in the corporate income tax rate creates a case of a "sore thumb" in state tax policy, to borrow the term used by Urban Institute fiscal expert John Shannon. While Pennsylvania raised its rate, Connecticut lowered its corporate rate, which previously had been the nation's highest. Now the Keystone state has the highest rate in the nation, about twice the median rate which hovers between 6% and 7%. No one knows exactly what impact this will have on economic development, but Shannon argues that "sore thumb" policies have a negative effect as indicators of attitudes of state officials that go beyond the effect of the taxes themselves.

This Pennsylvania decision may be reversed. The state's business community is conducting a major campaign against the new business taxes. The Senate (R-majority) has already passed a measure this year to reduce business taxes including the corporate income rate. The Casey Administration is blaming the result on others as indicated by an OpEd appearing in the Harrisburg Patriot News (2/13) where the state budget director says, "the business community was beaten in the halls of the Legislature by lobbyists from the liquor and tobacco industries. Instead of contributing $300 million to pay for the medical and social programs to alleviate the problems their industries produce, as the governor requested, the tax burden was shifted to business." Rolling back the corporate rate to single digits wouldn't be a new experience for Pennsylvania. The rate was once 11.5% and was gradually whittled down in the 1980s in the name of economic development to 8.5%.

TECHNICAL NOTES

Federal Policy And State Issues: The study of impacts of federal economic stimulus tax proposals is Federation of Tax Administrators (444 North Capitol St. NW, Washington, DC 20001), Impact Of Federal Tax Changes On State Tax Systems.

The National Conference of State Legislatures and the National Governors' Association, through their jointly managed Federal Funds Information For States (400 North Capitol St., NW, Washington, DC 20001), produce detailed and sophisticated analyses of federal budget proposals such as Budget Of The United States Government: Fiscal Year 1993, An FFIS Special Analysis (February). These state groups may now do better at watching grants than federal officials. The FFIS estimates have a footnote indicating the estimates include large amounts (e.g., $1.9 billion in 1993 budget authority) "inadvertently excluded from the President's 1993 Budget grants-in-aid summary table."

State Economic Momentum: The Index of State Economic Momentum, prepared quarterly by **Reports**, measures the *difference* between performance of economies of each state and the nation's performance. It is the average of differences for the latest annual period with statistics available for growth in: population, personal income, and employment.

The national pace is currently slow with a 2.8% growth in income combined with a gain of about 0.76% in population and a loss of 0.76% in employment. Nevada, for example, gets its 2.4 Index by being ahead of the national average by about 1.2% in personal income, 0.5% in employment, and 5% in population growth. The Index and employment changes by state were calculated by **Reports** in more detail than shown, so apparent ties are not ties, but ties in the personal income table represent equal values presented in the Commerce Department data. Farm income statistics come from the Department of Agriculture report, Agricultural Income And Finance (Dec. 1991).

Defense Spending: The Congressional Budget Office study (The Economic Effects Of Reduced Defense Spending, February) concentrates on a scenario that uses the defense savings to reduce the national deficit. This scenario makes the reduction a depressing influence on the national economy through 1995 but a stimulus later through increased private investment and greater exports. A version of this scenario is already built into the models used for forecasting the national economy for use in revenue projections by the federal government and most states. Alternative approaches replace defense spending with immediate consumer spending through tax cuts and/or government spending on public works and other programs. The conventional wisdom is that these approaches are less depressing in the short run, but less stimulative of long-term growth.

Evaluating Governors And State Policies: Stephen Moore's study for the CATO Institute (224 Second St., SE, Washington, DC 20003) is titled A Fiscal Policy Report Card On America's Governors. The three governors elected in 1991 are excluded along with Vermont's newly inaugurated governor and Governor Hickel because Alaskan policies have "peculiarities." Besides the problem of blaming and crediting governors for what they didn't cause, there are technical problems too numerous to cover in detail.

For example, the many governors elected in 1990 and inaugurated in 1991 had their first significant impacts on spending and taxes for FY 1992. There are no reliable data on state and local spending and revenues for FY 1992, which doesn't end until this June. Rather than concede that data won't support assessing these governors, the study assumes that the general fund appropriations were a proxy for future totals. Not true. Some states (e.g., Massachusetts and Michigan) built massive underestimates of spending into their budgets that are now appearing as supplemental budgets. The problems with FY 1992 are even more severe for deficit numbers which come from State Budget & Tax News calculations based on an NCSL survey. SB&TN's assessment (Vol 11, No. 1) in printing them was, "Some of the revenue shortfalls in the table are implausible."

The study uses state spending as a proxy for state and local spending. But some states (e.g., Nebraska) upped their taxes to lower local taxes while others (e.g., Massachusetts) shifted state fiscal problems to local governments. The same problem arises with state personnel counts, ignoring effects when states expand local rather than state employment.

There are also the kinds of errors that would simply be marked wrong in a student paper. One is measuring change in revenue in relation to personal income, which is appropriately done by using information for the same year for each. The study seems to use revenues for different years divided by income for one year, which measures only the revenue change. A harmless, but sloppy error, is measuring tax revenues "per family." This would produce interesting results because some states (e.g., Utah) have substantially more persons per family than others (e.g., West Virginia). These results don't appear because families aren't used except as a construct of four people -- that is, family burdens are per-capita burdens multiplied by four. This is like taking a crowd of 4,000 at a statehouse rally and announcing that 1,000 families were present. The alternative form of presentation doesn't convey added information and is factually incorrect.

The CATO results are so politically potent in some states that there have been attempts to replicate the numbers -- that is, to repeat all the calculations to try to get the same result. The players haven't said anything public yet (and may never), but it would appear that this process is resulting in some admitted problems, which could lead to revisions in the rankings without modifications of the basic concepts.

Gubernatorial Leadership And State Policy (Greenwood Press, 1991) isn't a must read. When translated into English from academic jargon, many of the conclusions are trivial. For example: (1) don't assume a governor is powerful because a large percentage of his legislative program passes if he is just endorsing legislation that would pass anyhow. (2) what a governor can do is limited by his legal authority, and (3) if Republican and Democratic governors act more alike in dealing with Medicaid, party differences in how states handle the program will disappear. The book is full of paragraphs that aren't easy to understand and, once understood, make one wonder whether the understanding was worth the effort. An example is a long passage (p. 85) on the "symmetry of cubes" that leads through inaccurate geometry to the conclusion that "particular attention must be given to the exact shapes of the cubes within which governors define their roles."

The Green Index: The Green Index was developed by staff members of the Institute of Southern Studies and published by Island Press (1718 Connecticut Ave., NW, Washington, DC 20009). It is, at a minimum, a good source of data on subjects like land use, recreation, and the environment. It is well documented with sources and values and ranks for each of the 256 variables.

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IN THIS ISSUE

There is little sign of resolution of key tax and spending issues in the large states. The problem is that all the options are unacceptable. Traditional supporters of higher taxes and of sharp spending cuts are more timid than usual. Contrary to popular impressions, federal aid cuts aren't causing the problem and layoffs aren't providing solutions.

- Tough Times, Tough Choices p. 2

The public wants more spending on specific programs, less spending in general, and no tax increases. Americans don't trust elected officials to reconcile these conflicts.

- Public Opinion On State Issues p. 9

Rankings of states in ensuring job safety reflect some federal, not state, decisions and obscure controversial policy choices.

- Safety In The Workplace p. 15

Many state tax issues are in court. The outcomes could increase state revenues in one case, but cut them in the others.

- Legal Challenges To State Taxes p. 17

Federal and state officials share responsibility for delay in attempts to hasten economic recovery by faster spending of highway funds.

- Accelerated Highway Spending p. 19

Criticism of state industrial development activities as a "zero-sum game" hasn't discouraged aggressive attempts to lure business.

- Smokestack Chasing Isn't Dead p. 21

Technical notes detail sources and caveats.

- Technical Notes p. 23

STATE POLICY REPORTS

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April 1992 (First Of Two April Issues)

TOUGH TIMES, TOUGH CHOICES

Are Budget Decisions Harder This Year?

Every spring, state leaders bemoan the difficulties of reaching agreement on budget and tax issues. Sometimes they say that the difficulties are greater than in previous years. Because such complaints are common, particularly when state treasuries aren't flush with unanticipated revenues, it is hard to conclude that this year is somehow harder than others.

There are indicators that the choices are harder this year -- even harder than last year when nine states were late in adopting budgets, over half raised taxes, and most provided funding for higher education at below current service levels. The fiscal situation is bad for the second legislative session in a row. Legislators face reelection in most states, many in less secure reapportioned districts. Public opinion polls and Presidential primary results indicate a heightened distrust of incumbents. More legislative leaders seem to be complaining about the difficulties in producing a budget they find acceptable.

Extraordinary Problems In The Nine Largest States

Every one of the nine largest states, together accounting for over half the nation's population, faces particularly difficult budget problems this year. As yet, there is little sign of resolution in any of them.

California and **New York** should have acted long ago because their problems include serious FY 1992 shortfalls and because the New York fiscal year starts in April. **Florida** should have been the first of the other states to make decisions because its legislative session ends in April, but it is nowhere near budget decisions. **Illinois** many have the most realistic schedule. It dealt with current year imbalance in a special session, but changed its budget schedule to move the governor's budget submission to April.

Illinois, **Michigan**, and **Ohio** face similar problems. Their governors have strong stands against general tax increases and both Edgar in Illinois and Engler in Michigan are standing against any tax increase. With few exceptions, election-bound legislators of both parties have no interest in tax increases either. Current budgets are out of balance despite the sharp welfare cutbacks in Michigan and Ohio and mid-year corrections in Michigan. Actions to restore balance by further cutbacks this winter are proving inadequate. School equalization issues are pending in all three states. A revolt of property taxpayers is particularly strong in Northern Illinois and Michigan. **Ohio**'s FY 1993 budget, previously enacted as the second year of a biennial budget, is clearly out of balance. **Michigan**'s FY 1993 governor's budget submission is out of balance, though there is disagreement over how badly. On a current service basis, the new **Illinois** budget will be out of balance without sharp spending cuts and/or tax increases.

In **New Jersey** and **Pennsylvania**, the previous large tax increases don't seem to have provided enough to keep the FY 1993 budget in balance assuming all current taxes stay in place. The initiative has been seized by those who want a tax cut this year. In **New Jersey**, the Republican legislative majorities swept into office in late 1991 after the tax increases of 1990 have promised a rollback of the sales tax. In **Pennsylvania**, the governor insists that the personal income tax rate drop, as it is scheduled to do under the tax increase legislation passed in 1991. Proponents of the tax cuts have spending cut proposals that won't be easily accepted. The New Jersey proposal cuts back scheduled school aid increases to promote urban education and satisfy equalization requirements of the state supreme court. The Pennsylvania budget proposal freezes school aid and eliminates the extensive state support of private higher education.

Florida shows signs of repeating last year's chaotic budget battles in Connecticut, with an independent governor vetoing fiscal measures until presented with one conforming to his views. Governor Chiles (I) recommended $1.3 billion in tax increases. He vetoed the more austere budget passed in the regular session. Round Two will be fought at a special session in mid-May. **Texas** is financing schools through next summer with what its supreme court says is an unconstitutional system, right down to its local property tax component. Some taxpayers are in court disputing the concept that a court can decide something is unconstitutional, but not until next year. Legislators are discussing not making a third try at tax increases and school formulas, instead letting the courts devise their own plan.

Inaction In New York And California

> *The legislature, despite the lateness of the hour, has no real sense of urgency. They're having difficulty making even the simplest decisions.*

This late-March lament from Governor Cuomo reflects concerns in both **California** and **New York**, which contain nearly a fifth of the nation's population. Late last year Governors Cuomo and Wilson announced that the FY 1992 budgets were out of balance and urged quick legislative action. Legislative analysts agreed that the problem exists and, particularly in California, suggested it was worse than the governor had indicated. Everyone agreed that the problems infecting the current year would infect FY 1993 as well -- that the problems would cumulate until solved as one year's deficit poisoned the fiscal situation the next year. Everyone knew that tax increases, fee increases, and some expenditure cuts have leadtimes. So action in the spring was necessary to have full-year effects in FY 1993. Winter action was needed to have much impact on FY 1992.

Nothing has happened.

No Place To Go, No Place To Hide

The lack of action is partly caused because state leaders don't know what they want to do. This isn't normally the problem. Usually leaders know what they want to do and delays result from clashes with other leaders with different ideas. This year, many leaders haven't figured out what they want to do. This, rather than conflicting prescriptions of what to do, appears to be contributing to inaction.

John Vasconcellos, who chairs the House Ways and Means Committee in California, described this situation in February comments to the committee:

> *I have no idea how to fix this budget. I have never before not known how to do that in my 12 years as Ways and Means chair.*
>
> *It looks to me like if we raise taxes any more, we are arguably going to hurt the recovery from the recession, which is damaging in the long run. And if we cut services any more, we are going to so destroy people's lives and health and education that there won't be a workforce anymore. It won't be a viable state and a competitive state.*
>
> *It is too easy to do stereotypical left-wing or right-wing slogan solutions that can only exacerbate the state's tragic bankruptcy. That's what worries me the most, especially in an election year.*

Opposition To Budget Compromise Stronger Than Ever

> *I'm not going to let anybody back me into a corner and put a gun to my head.*

Because **Maryland** is on a faster budget schedule than most states, comments like this one are being heard there first. Maryland should have an easier time than many states because the governor and both legislative majorities are of the same party. Unlike California and some other states, extraordinary majorities aren't necessary to adopt budget and tax measures. Despite these advantages, the House speaker had to reverse his own opposition to higher taxes to find a bill that had a chance of getting a House majority. Then he had to issue only his second "leadership call" in six years. The call asks legislators in leadership positions to support a measure or surrender their leadership positions. The quote is from an assistant whip likely to become a backbencher.

Getting a majority for a tight budget containing revenue increases and cuts in current service spending is never easy. A significant group of legislators won't vote for any bill with a tax increase in it. Another group will vote for tax increases, but not if the legislation also cuts spending important to their constituents.

Party discipline may get majorities in Maryland, but can't work in the nine largest states except Texas. None of the others have the same party in control of the governor's office and both houses of the legislature. So each party has what amounts to a veto.

Traditional Positions Have Become Uncomfortable

As leaders search for agreement they are finding unusual difficulties because many legislators are uncomfortable with their own traditional positions on fiscal matters.

The tax-and-spend crowd doesn't want to raise taxes. Legislators, even those most fond of more spending, really don't like raising taxes. This year there are many special arguments against the idea.

First, many tax choices that appear likely both to raise significant money and obtain majority votes are regressive, hitting hard the low income citizens tax-and-spend legislators like to protect. Examples: a gas tax in New York, higher excise taxes on alcohol and tobacco in many states, taxes on snack foods in Maryland, and indirect taxes on utilities.

Second, legislators are sympathetic to the economic argument that they shouldn't be hitting people with tax increases when they are suffering from recession. Rephrased, they buy the argument that when people are tightening their belts, state government should do the same. Third, this is an election year with many legislators facing reapportioned districts and widespread anti-incumbent sentiment.

The cut-the-budget crowd doesn't want to cut spending. In deciding whether to vote for budget cuts, legislators don't get the chance to vote to cut fat, waste, fraud, and abuse. They vote on issues like the amount and distribution of school aid, whether to eliminate recipients or services from Medicaid, and how much to pay employees. The spending cuts available for approval in a yes-or-no vote on a budget package may well not be the ones many anti-tax legislators find acceptable.

Easy cuts aren't enough. The comfort level of cut-the-budget legislators is often highest with cuts affecting welfare cash assistance and state employees -- their number, their pay, and their supplemental benefits. Such have limitations in the budgets of large industrial states, particularly California's.

First, budget cutters already went this route last year. Second, counting on savings involves risk because of: (1) possible federal disapprovals (AFDC payment reductions), (2) state litigation (welfare and employee pension changes) leading to delays, if not disapproval, and (3) inaction such as that affecting layoffs. Third, many legislators whose votes are needed for budget plans with tax increases won't back a bill with big cuts affecting welfare recipients or public employees. So compromise bills requiring decisions won't necessarily have these cuts.

Besides these problems, cuts in these areas won't save enough money in some states. The governor's budget in California already reflects considerable restraint in employee compensation and sharper AFDC cuts than the California legislature would likely accept even in the worst of times. Despite incorporating these cuts and cutbacks in higher education, the California executive budget is badly out of balance.

Other cuts are harder than they look. The spending cuts apparently needed to avoid tax increases require attacking Medicaid and/or local aid, particularly school aid. These choices strike hard at the heart of constituencies of legislators from suburban and rural districts, the (usually but not always Republican) legislators who would be at the center of budget cutting. The details are complex. Because they are complex, some legislators don't understand their constituents' concerns until late in the budget process when they see print-outs of proposed school aid allocations and hear from health care professionals and employers about Medicaid.

> **School Aid For Suburbs**: In California's environment of equalized spending on schools, the basic way that school aid must be cut is by lowering the per pupil spending in the state school aid formula. The net effect is to concentrate the budget cuts on districts the formula defines as middle and upper middle income in terms of ability to support schools with local resources. This is understood by legislators, though not by the press or public It is why Republicans in the Illinois legislature in 1989 wanted a *bigger* tax increase than Democrats did. In New York's school aid the situation is more complex. It involves less school equalization and more making sure not to throw New York City into crisis, but the result is basically the same -- suburban constituencies would be hurt the most.
>
> **Medicaid Protecting Employer Health Plans**: Without a change in Medicaid eligibility, Medicaid is fundamentally two separate problems: nursing homes and all else. In the all else category, a substantial case can be made that costs removed from Medicaid, particularly hospital costs, will remain costs in the health care system but be doubled in price because a 100% in-state cost is substituted for 50-50 cost sharing with the federal government. If this is true, or even partly true, the costs will migrate into employer costs for hospital coverage in their health insurance plans. Fear of this result causes pressures on legislators from health care professionals, hospital administrators, and some business groups to avoid such cost shifting.

Postponement As An Option

With elections approaching and choices difficult, postponing major fiscal decisions obviously has its attractions. Some legislators would rather risk the disapproval of the bond rating agencies than voters. There are already examples of postponement.

After nearly two years of debating enactment of a personal income tax, **Tennessee** legislators have rejected the idea in favor of a half cent increase in the sales tax. The increased spending being financed is ongoing but the 6% tax rate reverts to 5.5% in June of 1993. As a result, taxes will be back on the agenda next year.

After taking the pulse of **Oregon** voters, the governor has decided not to press fiscal reform ideas this year. But a voter initiative has put the state on a schedule of reducing property taxes and replacing the revenue with new state aid that will force reconsideration of the state's tax system -- if not this year then next year.

Putting off fiscal problems by such devices as borrowing from other state funds and from the public, by late payment of bills, and by other available means has been the strategy of choice in **Illinois.**

Postponement has significant opposition in many legislatures, despite its apparent political advantages. Some key groups, such as business leaders and educators, sometimes argue that legislators should face the hard choices. Some legislators, including legislative leaders in many states, are opposed in principle to what they call budget gimmicks.

The Second Massachusetts Miracle?

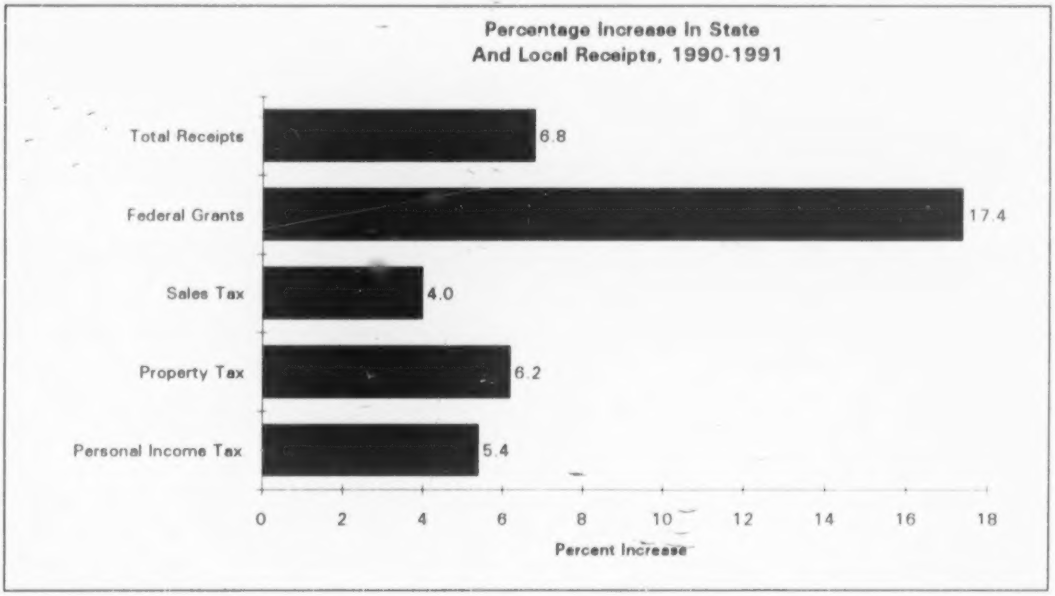
Mixed news on Massachusetts finances continues to flow. The subject is of national interest because the state's fiscal policies and Governor Weld's leadership have been seized by some prominent observers, such as the editorial writers of the Wall Street Journal, as models for other states. The good news includes predictions of FY 1992 tax collections that exceed those underlying the budget by as much as 12%. The bad news is that overestimates of non-tax revenues and underestimates of spending may offset the good news.

The other bad news is that deviations this large from budget estimates don't inspire confidence in financial management. Moody's and Standard and Poor's reassessed their Bay State bond ratings in March, concluding that the state should retain the lowest rating in the nation. S&P did put the state on its CreditWatch list of possible rating changes, indicating an upgrade might be considered when the FY 1992 results and FY 1993 decisions are known.

The fear, as described in a five-page analysis in State Budget & Tax News (2/20), is the simultaneous success of two policies. The opponents of spending cuts could prevail by a combination of legislative inaction, court decisions, executive branch reversals, and unanticipated adverse circumstances. The governor and other proponents of tax cuts -- including a key one that is scheduled under current law -- could prevail in reducing revenue. The governor doesn't appear to be bucking tax cuts not in his plan, such as an estate tax cut he says he would sign. Legislators aren't likely to block cuts scheduled under current law and may support business tax cuts proposed by the governor.

Declining Federal Aid Or The Federal Fix?

The chart below dramatically shows that cutbacks in federal aid have *not* contributed to current state and local fiscal problems. Rather than causing those problems, federal aid has been rising at twice the rate state and local governments have been tapping their own revenue sources.



The data reflect state and local revenues in the last quarter of 1991 (seasonally adjusted at annual rates) compared with the same quarter a year earlier.

State fiscal problems can't be explained as a lack of federal money. The federal causes are more complex -- including mandates, federal judicial pressures on spending, and lack of growth in several key programs. The sharp federal aid growth is itself a mixed blessing. The increases are driven primarily by AFDC and Medicaid. The same factors producing double digit increases in federal aid for them drive rapid state spending growth.

Widespread Layoffs Not Solving Problems

Widespread layoffs of state employees aren't being used as budget strategies. There has been considerable publicity about cutting state payrolls and layoffs, but most of it has been about what might happen. Some layoffs have been announced, but not implemented. The result is a series of assessments contrasting promise and performance such as "Pink Slips For Paper Jobs" (City & State, 3/9) and "The Shrink-Proof Bureaucracy" (Governing, March).

A major source of state fiscal problems has been expanding workload -- more prisoners to guard, more parolees to supervise, more child abuse cases to investigate, more children to monitor in state-supervised settings, more AFDC recipients to monitor and pay, and more Medicaid claims to review. With no sentiment to change ratios of front-line workers to workload (e.g., prisoners per guard, abuse claims to investigators), state staffing would be expected to increase, not decrease. In other state labor-intensive activities (e.g., highway maintenance and tax collection), there hasn't been strong sentiment for cutting jobs. In overhead and administrative functions, where sentiment to cut jobs is strong, there are many fewer jobs. So net employment cuts are hard to realize.

Impressive job reductions can be obtained in a few areas, but generally involve shifting jobs from the state payroll to a local or private payroll, not necessarily net savings. Examples are closing state mental institutions and replacing them with purchased care in private and community programs, selling state liquor stores, and contracting for functions like data processing, janitorial services, and food service in state institutions.

PUBLIC OPINION ON STATE ISSUES

Polls indicate it. Pundits pontificate about it. Politicians perceive it.

It is the mood of the public, and it is foul.

This assessment in Changes In The Legislatures begins a discussion of term limits-- "the single biggest change facing legislatures in the coming decade." *De facto* one-term limits for governors imposed by angry voters are the subject of a recent Neal Peirce column (3/29) with the catchy title, "Governors And Voters: Hard Times And Hard Feelings."

Elected officials have many reasons to feel besieged -- scandals affecting the Congress and some legislatures, media attacks, the term limit movement, and more. In this context, the news about public opinion in this article is all bad. The public clearly prefers that legislators do what their professional staffs say can't be done -- find ways to tax less and spend more.

Term Limits Get Green Light

In March, the U.S. Supreme Court declined to consider challenges to Proposition 140, the California measure limiting legislative terms and reducing the size of legislative staffs. The decision, which lets stand the California courts' approval of the measure, means all legal challenges have been exhausted. California legislators are now considering going back to voters to attempt to salvage their legislative fiscal and auditing staffs. Two other states have passed limits. At least three more will have them on the ballot this year.

One reason for the difficulties that governors and legislators are experiencing with state budgets this year is the chasm between what the public supports and what appears to be necessary. Legislators are resisting leadership calls, like the one in Maryland, for what seem to them to be good reasons. They are being asked to violate the apparent wishes of their constituents, to violate their own often sincere campaign promises, to offend many of their contributors, and to provide ammunition to their opponents. This is not fun, not psychologically rewarding, and not likely a good move to further a career as an elected official.

One solution not likely to be palatable to many elected officials is to create an army of expendable volunteers who will successfully run for office, "do the right thing," and then retire to some other line of work. This is essentially what Governor Chiles asked Florida legislators to do. It is also the prescription of state fiscal expert Steven Gold, as quoted in the conclusion of Neal Peirce's column on the unpopularity of governors:

> *We need more people who don't care about being reelected who'll do the right thing for their states. Otherwise, the states won't bite the bullet.*

Public opinion doesn't have to be rigorous, and generally isn't. A major problem in interpreting the type of polling data presented in this article arises from the assumption that there will be some rigor in the results. There often isn't.

Opinion poll results are highly sensitive to how questions are presented. For example, a recent Illinois comparison of program popularity ranked spending for *prisons* lower than spending for *low income families*. Changing *prisons* to *keeping criminals off the streets* would have improved the ranking considerably. Changing *low income families* to *welfare* or *welfare recipients* would have reduced the score, but changing to *needy children* would improve the score.

Answers indicating that respondents are willing to pay more taxes for some public function like education have several problems. One is that the amounts being considered by respondents are often considerably less than the costs of policies the survey readers have in mind. A second is that attacks on incumbents by challengers don't take the same form as the polls. The attack is INCUMBENT RAISED TAXES, not INCUMBENT RAISED TAXES FOR SCHOOLS. Attacks don't need to be logical, just effective. But if logic is required, it is that the incumbent should have provided the money for schools out of existing low priority programs, rather than raising taxes.

Voters' views on taxes and spending are notoriously dependent upon whether a change in policy is involved. Voter support for federal tax cuts is relatively soft, and initiatives to repeal existing taxes generally fail at the state level. But voter opposition to tax increases is generally high. Measures to raise state taxes, like the Missouri 1991 one, often lose by wide margins.

Tax And Spending Choices

An exit poll after the primary voting in Michigan in March provided a somewhat surprising preference for economic stimulus measures over tax cuts. Of course, voters in a Democratic Presidential primary aren't representative of Michigan voters and Michigan voters aren't necessarily representative of voters elsewhere. The question was, "Which should be a higher priority: -- Providing incentives for economic growth or a tax cut for the middle class? Sixty-two percent picked the incentives while 35% opted for the tax cut, with the rest not knowing. The same question in the Illinois exit poll produced a 60-36% margin for the growth incentives.

Another poll shows that interest in a national middle class tax cut depends heavily on how the question is phrased, a result that probably would be obtained from asking similar questions about state tax cuts. When a national sample of voters was asked if they favored or opposed "cutting taxes enough to save most Americans up to $400 a year," 65% said yes while 27% declined the offer. The second formulation was, "Some people say the federal government should cut taxes enough to save most Americans up to $400 a year. Others say such a tax cut is too small to stimulate the economy and would increase the large federal budget deficit. Do you favor or oppose such a tax cut plan?" Support was 47% with 42% opposition.

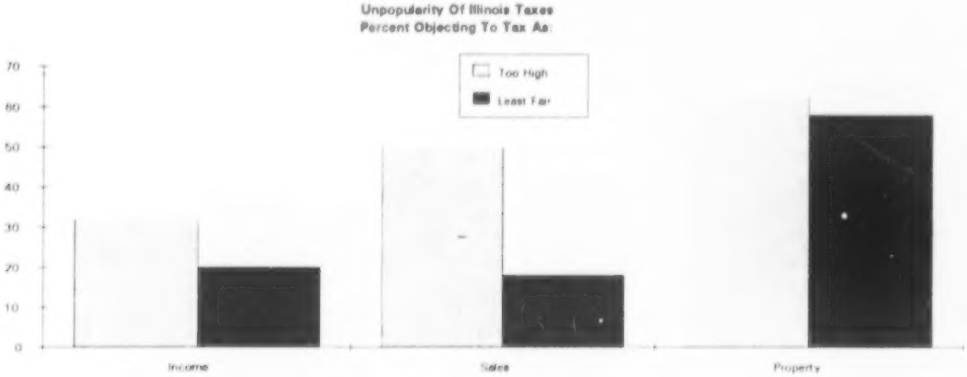
An annual Illinois poll confirms common patterns of voter preferences, particularly the dual preference for higher spending and lower taxes. Higher state spending for public schools appeals to 77% of the voters, followed by 62% for job training and medical care, 54% for higher education, 52% for the environment, 48% for low income families, 35% for economic development, 32% for prisons, and 25% for roads.

A Montana poll asked which spending people would be willing to pay higher taxes to support "if spending cuts alone won't balance the budget." Elementary and secondary education got 73% support followed by 69% for vocational and technical education, 59% for higher education, 56% for social programs and public assistance, and 50% for state institutions such as the state mental hospital and prisons. As found in other surveys, the support for school spending is weakest among those over 65 and strongest among those under 35 and college graduates.

Property Taxes Least Popular

The Montana poll asked for the preferred method of raising revenue and gave choices of adopting a sales tax (which Montana does not have), increasing income taxes, and increasing property taxes. Four percent rejected the question, saying spending should be cut. The sales tax drew 42% support, followed by the income tax at 22%, and the property tax at 8%.

The graph shows the relative unpopularity of the three major sources of revenue in Illinois. Property taxes are more likely than the other two to be considered too high and more unfair. Dissatisfaction with the income tax is probably lower in Illinois than some other income tax states because there is no local tax and the state tax is levied at a low flat rate on a broad base. The property tax in Illinois is probably less popular because Cook County has a unique system of rolling quadrennial assessments. The resulting differing interactions of tax rates and reevaluations are considered unfair and arbitrary by those who don't understand the system and by the handful of people who do.



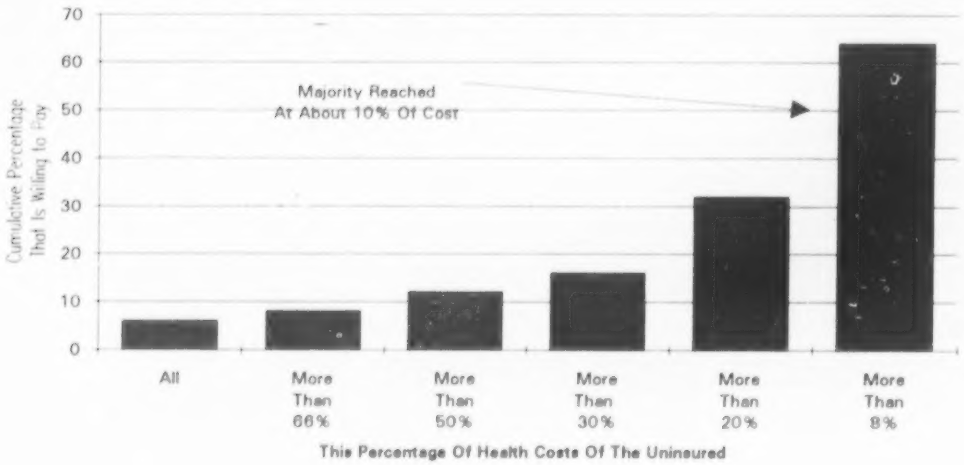
Health Care Should Be Provided At A Tenth The Price

Sixty percent of Americans believe there is a need for major reform of the nation's health care system. Over 70% agree with the statement, "Changing our health care system would cost everyone more money either in higher taxes or higher personal health care costs." The majority of Americans don't know what the Medicaid program is. Given brief descriptions of five radically different national health plans, ranging from a government-run system to a totally private one with tax credits, a majority of respondents favored each of these inconsistent plans.

Health care reform isn't important personally for 52% who say their personal health care situation is satisfactory and another 10% saying only minor changes are needed. Two-thirds are confident they have adequate insurance to meet the cost of a major medical expense. The satisfaction with health care and health insurance coverage among those under 65 rises to 78% when only persons with private health insurance are considered. Dissatisfaction, and support for health care reform, is highest among those of low incomes and those without insurance. So support for change is lowest in the groups with the highest voter turnout -- those over 65 and employed, higher income persons.

There is considerable support for considering health care as a right. However, when asked to consider the costs of making it a right through government-sponsored plans, the public balks. The graph below was constructed (see Technical Notes) from public opinion data to show the feasibility of a government-sponsored health plan covering the uninsured. The concept enjoys broad support with two-thirds of those surveyed willing to pay something for it. But what they would be willing to pay doesn't approximate the cost of doing what they favor. Less than 10% say they are willing to pay all the costs. To get a plan that would cover all the uninsured would cost about $600 a year for every adult in America. To get a price for a plan that is acceptable to a majority, the price needs to be around $60 a year for every adult.

**Majority Supports Health For Uninsured
Only At Ten Cents For A Dollar**



School Spending Should Be Equalized Up

A recent Kansas poll indicates endorsement of substantial school finance equalization and a statewide property tax by 61% of the electorate, with 27% rejecting the idea. These results are probably a better indicator of the limitations of such polls than of support for particular school financing concepts. The exact question was:

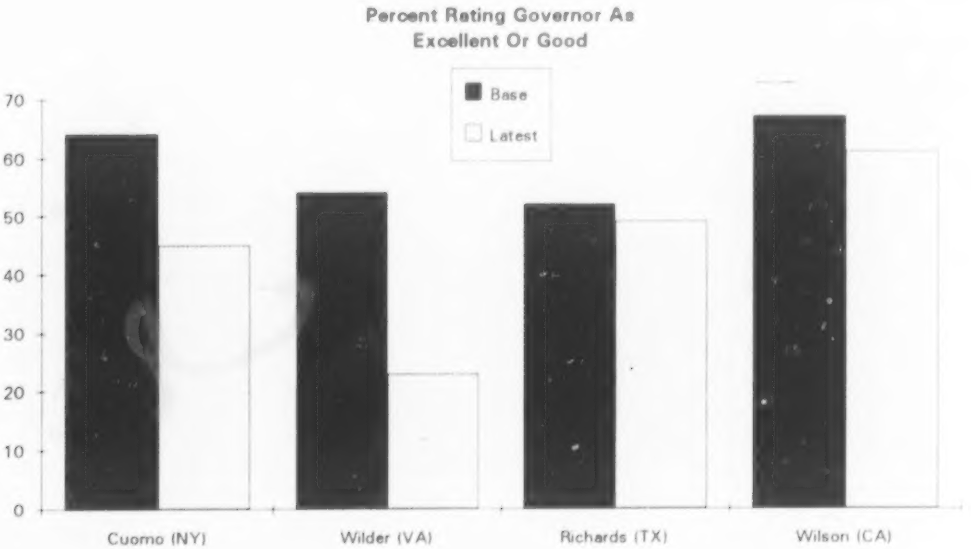
> *Per-student spending varies widely by school district. Some argue that this creates unfair educational opportunities because students in poorer districts do not have as much money spent on them as students in richer districts. Do you think the state should set the same property tax statewide and require that each district spend roughly the same amount per student?*

Responses to the follow-up question indicated that about half of respondents would abandon their support if the new approach raised their property taxes or reduced what their local schools had to spend. Any new school finance program will have precisely this result unless: (1) the state kicks in new money or (2) the voter lives in a district with exactly the average tax base per pupil *and* a tax rate equal to the new local effort requirement.

Elected Officials Are Doing A Poor Job

Public disenchantment with government officials in general and legislatures in particular seems to be rising. For a good summary, see Alan Ehrenhalt's article "An Embattled Institution" in Governing (January). Sample line: "For America's legislatures, 1991 was a year only a cynic could love."

At both the national and state level, approval ratings for legislatures tend to be lower than those for chief executives. Rankings of chief executives have been dropping as shown in the chart. It compares ratings of doing a good or excellent job between surveys taken in late 1990 and 1991 and surveys taken more recently.



Governors and legislators are swept by the tides affecting how the public perceives authority figures generally, by well-publicized ethics problems, and by association with the national and state economic problems. This year state officials are in the public eye bringing bad news, like tax increases, and arguing among themselves over what additional bad news to bring -- publicity not destined to make them popular.

Fighting Back In Oklahoma

The conventional wisdom is that elected officials shouldn't pick fights with anyone who buys ink by the ton. This made Governor Walters' state-of-the-state address one of the more unusual events in the early months of state legislative sessions. The governor used more than half of his speech to criticize media coverage of him and his family.

He has lots to complain about. Through much of 1991, the big news in Oklahoma was a federal investigation, later dropped, of an allegation that he offered campaign workers future jobs in exchange for contributions. In November, his 19-year-old son was charged with the misdemeanor of possessing drug paraphernalia after pipes commonly used for smoking marijuana were found in his apartment. The police sought to build a drug possession case by sprouting some of the seeds found, keeping the local media informed daily on progress. The seeds turned out not to be marijuana, but not until after what the boy's mother counted as 47 TV news stories in a single week. He pleaded no contest to the paraphernalia charge, though saying the pipes belonged to a friend. In mid-December he committed suicide, an action to which the parents believe press contributed, if not caused.

The governor concluded, "The two most important things to me, my family and my integrity, have been virtually destroyed." Afterwards, he commented that if his son's death leads to more fairness in treatment of elected officials by the media it will have contributed something. His concerns attracted media attention and some editorial support, such as a characterization by Forbes (3/30) of the coverage of the son as a "media wolf-pack attack."

SAFETY IN THE WORKPLACE

What the data clearly show is that state decisionmakers ... have a large influence over the forces that shape job health.

This is the premise of a new set of state rankings of occupational health and safety programs. Like just about any ranking of states, it was widely covered by the media, particularly in the low ranked states. Interest was heightened by the fact that Arkansas was ranked last. Release of the study shortly after a plant fire in North Carolina that killed 25 workers, the most fatalities in an industrial setting in at least five years, also added interest. The Arkansas Democrat Gazette (1/1) headlined, "Study Ranks Arkansas Last In Job Safety." Governing (March) printed the rankings.

In concept, these rankings don't make sense as evaluations of state policy. The cutting edge of policies to prevent workplace accidents is *federal* Occupational Safety and Health (OSHA) legislation which preempts the field. The major state issue is whether to assume responsibility for administration. Some states do. Some don't.

Should States Administer OSHA Programs?

States have the option of administering their own programs subject to federal guidelines and supervision, which 21 states do. Or, they can let federal officials take full responsibility, which 29 states do.

Which is the best approach for ensuring worker safety? There are strong arguments on both sides. The answer isn't necessarily the same in every state. It partly depends on how individual states would administer the program relative to federal administration. Over the years, organized labor and organized business have been on both sides of the issue, suggesting pro-labor and pro-business positions aren't obvious.

Federal Is Better, North Carolina: After the Hamlet, North Carolina disaster, there was a widespread presumption that the problem arose because North Carolina was one of the states that opted to administer the program. Shortly after the accident, federal officials announced that they were asserting concurrent jurisdiction with the state. This action makes sense if it is assumed that state administration in general, or at least North Carolina's, is less effective than federal.

State Is Better, California: The reverse presumption has permeated treatment of the issue in California. California administered the law until 1987, when Governor Deukmejian (R) vetoed funding for state administration and the legislature (D-led) failed to override the veto. This put California in default of its agreement to administer the federal law, so the federal government was forced to take over. The rationale for the governor's action was saving money -- getting enforcement free from the federal government rather than sharing costs 50-50. It was widely believed that the move was pro-business, anti-labor as well, designed to relieve unnecessary regulatory burdens at a minimum and at maximum to improve California's business climate at the expense of worker safety. Organized labor used the initiative process to take the issue to California voters, who approved resumption of state responsibility in a November 1988 vote. California was recertified and resumed state administration in 1989.

No Clear Answer, Most States: There are clear patterns among states in labor law. Some states have labor-favored policies like little Davis-Bacon acts, collective bargaining for public employees, higher minimum wages than the federal level, high Unemployment Compensation and Workers' Compensation maximum payments, liberal eligibility for WC and UC, and no right-to-work laws. These policies are highly correlated -- a state with one is likely to have others. Taking control of OSHA administration doesn't fit this pattern. Some states with labor-favored policies run their own program -- Hawaii and Michigan, for example. Other states with labor-favored policies -- Massachusetts and Rhode Island -- let the federal government handle it. On the other side, Indiana, the Carolinas, and Utah run their own programs, but Alabama, Arkansas, North Dakota, and Texas rely on federal enforcement.

Wrong Rankings For Wrong Reasons

Ranking States For Federal Decisions: How can one compare OSHA activities of 50 states if 29 programs are run by one federal government? One defensible choice would be to decide whether federal or state administration was the right decision and award lots of points to the states making that decision. The study doesn't do this. Instead, it compares federal policies with federal policies and attributes the differences to states. For example, the mean federal fine for Maine employers has been $5,360, twice that of the next highest state (Texas, $2,150), four times the average ($1,260) and well above other states with federal administration like Arkansas, Kansas, and Louisiana -- all under $700. Maine gets ranking points for this.

Other Problems With The Rankings: The study has other anomalies. A major factor in the rankings is how many different medical conditions are "reportable occupational diseases." States vary all over the lot. Wyoming has none. Rhode Island has one. California has three. Most states have six or less. Michigan has 34, 49 if one counts separately all the types of poisoning listed in the report. More is better, according to the rankings.

Yet another factor is whether workers who come to work drunk and are injured get less compensation because of their contributory negligence. The original concept of Workers' Compensation was to deny this defense to employers, but it is now allowed in some states. Points are awarded for denying the defense.

Conclusion -- These Rankings Aren't Safe: The problem with these rankings isn't that they are biased. Neither ~~business~~ nor labor seem to have left any footprints in the acknowledgements or in the disclosures of financial support, which comes from foundations. The problem is that they don't make sense. If a state cut its workplace injury rate in half and another, by malicious policies, tripled its industrial accident rate, *neither state's ranking would change.*

LEGAL CHALLENGES TO STATE TAXES

Taxing Multistate Corporations: Considerable litigation is pending in many judicial forums on the question of how far states can reach to tax income generated in other states and nations. The law is settled that a state can consider a single corporation with a single business as an entity, regardless of where its income is actually earned. For example, Idaho can tax the income of the XYZ Company by allocating a portion of its nationwide income to Idaho based on factors such as the percentage of sales, payroll, and property in Idaho. Idaho doesn't have to listen to company arguments that its sales in Idaho were less profitable than in other states or that its Idaho plant is less profitable than its Georgia plant.

These issues are more exciting when the business is legally more than one company, such as XYZ Manufacturing based in Idaho, XYZ Franchise Operations, Inc., with no operations in Idaho, XYZ Overseas based in Portugal, and XYZ Holdings based in New York, which holds stock in the other companies. One sticky issue is whether states get to tax XYZ Holding's "passive earnings," such as interest on short-term investments. In March, the U.S. Supreme Court took the unusual step of broadening a case in which New Jersey and Allied-Signal are arguing over $1.8 million. Acting as though it wants to consider remaking policy on a broad front, it asked the parties to present arguments on whether earlier decisions on the subject should be overturned and, if so, what doctrines should replace them. It also invited third parties to present arguments.

Mail Order Sales: In January, the U.S. Supreme Court heard oral argument in the case pitting North Dakota against Quill Corporation, a major mail-order purveyor of office supplies. Quill has substantial in-state sales, but minimal presence there. Quill contends that under the 1967 *Bellas Hess* case, the state can't force it to collect sales tax. The state wants *Bellas Hess* overruled. The stakes are substantial, as much as $4 billion a year in state and local income nationwide. One tough issue, raised in oral argument, is the extent to which states would raise even more revenue by retroactive liability.

Even if they lose in court, states might be able to get Congress to pass a law expressly consenting to the state taxation. This would remove any objections to the state action as unconstitutional under the Commerce Clause. That legislation hasn't gone anywhere. Mail order companies oppose it, which isn't a fatal problem as long as there are offsetting voices from their taxpaying local competitors. But state and local officials are unable to agree on what they want Congress to pass. The dispute is over how to figure and disburse local sales taxes without making vendors figure them out for each sale.

While the issue is being litigated, more states are seeking to tax mail order sales. Indiana's new statute, like many others, extends liability well beyond *Bellas Hess*. At a minimum, this increases litigation costs and risks of retroactive liability for mail order companies. At maximum, it will force some to collect the tax.

Property Tax Discrimination: In February, the U.S. Supreme Court heard arguments in a case challenging the aspect of California's Proposition 13 that causes properties of equal value to have unequal assessments and thus unequal taxes. The result follows from applying current-value assessment to properties changing hands while capping valuation increases for other property. The resulting discrimination arguably violates the equal protection of the laws guaranteed by the Fourteenth Amendment. In a 1989 case involving assessments in West Virginia, the Court found unconstitutional discrimination.

Discrimination Against Interstate Commerce: The Supreme Court has agreed to review a challenge to Alabama's differential treatment of hazardous waste from in-state and out-of-state sources.

The Court will also hear claims by three New England states that New Hampshire's complex method of taxing the Seabrook nuclear reactor discriminates against commerce. They charge that New Hampshire is making power consumers in other states pay while shielding its residents. The issues weren't complex in Wyoming's case that Oklahoma was discriminating against commerce by requiring that in-state utilities burn local coal. The Court summarily rejected the Oklahoma law.

Retroactive Refund Liability: Many claims for retroactive refunds under the 1989 *Davis* holding (states cannot tax federal pension income while exempting state and local pensions) are still in litigation. Virginia is the state most at risk from an adverse holding.

ACCELERATED HIGHWAY SPENDING

> *There is plenty of money in the pipeline. It's that the spigot is not working.*

This is how U.S. Transportation Secretary Andrew Card described the failure of most states to move rapidly to put highway work under contract in order to help recover from recession. While 20% more federal highway funds have been obligated than last year at this time, he says the pace should be considerably faster.

Most state and federal economic stimulus packages are just talk so far. Proposals for new federal aid to accelerate public works are pending in the Congress where they may not pass and certainly won't be enacted quickly. Many state proposals require legislative, and often voter, bond-issue approvals that haven't been forthcoming so far. Many governors have talked of accelerating construction using funds already available, but some states are doing much better than others as shown by the table on p. 20.

Part of the problem was delayed passage of federal highway legislation. Last October, state transportation secretaries warned that delay had caused many states to put a hold on new projects and that lost ground might not be fully recovered. However, the mechanisms for accelerating spending are now in place. The U.S. Department of Transportation has cleared away federal hurdles to permit use of available highway funds with contracts let this spring.

Last year's highway legislation lets the states skip the matching fund requirements, provided only that they find the matching funds within two years. Only four states -- Alaska, Maryland, North Dakota, and Vermont -- are using this flexibility. A survey of state transportation officials in January indicated that only six states are likely to use it in FY 1992 and seven in FY 1993.

Percentage Of Available FY 1992 Federal Highway Funds Used, March 2, 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nebraska	72.6%	18	South Dakota	35.8%	34	Idaho	25.4%
2	Colorado	70.0	19	Missouri	35.6	35	South Carolina	23.8
3	Iowa	57.7	20	Montana	33.4	36	North Carolina	23.2
4	Wyoming	56.9	21	Texas	33.4	37	Kentucky	23.0
5	Louisiana	54.6	22	Maryland	33.1	38	Washington	22.6
6	North Dakota	54.2		**United States**	**32.3**	39	Alaska	19.2
7	Wisconsin	53.8	23	Delaware	31.3	40	Utah	17.4
8	Pennsylvania	50.0	24	Nevada	30.6	41	New Jersey	16.3
9	Oklahoma	46.4	25	Florida	30.2	42	New Hampshire	15.6
10	Massachusetts	45.7	26	Virginia	29.8	43	Ohio	14.8
11	Arkansas	45.6	27	Arizona	29.3	44	Vermont	12.8
12	Mississippi	45.6	28	Michigan	28.6	45	Alabama	11.8
13	New Mexico	44.7	29	Maine	27.9	46	Kansas	11.5
14	Indiana	44.2	30	Georgia	27.8	47	Hawaii	8.5
15	Tennessee	37.2	31	Oregon	27.5	48	Connecticut	8.4
16	Minnesota	36.8	32	New York	26.8	49	Rhode Island	7.6
17	California	36.1	33	Illinois	26.4	50	West Virginia	7.6

With the federal FY 1992 about half over, only about a third of the highway money has been committed. This isn't surprising because the peak contract-letting season is in the spring for construction to be performed in the warmer months. But winter weather didn't keep cold-winter states like Colorado and Wyoming from leading the list and doesn't explain Hawaii's or Alabama's low rank. The rankings indicate no geographic, economic, or political pattern. Among the depressed New England states, Massachusetts ranks tenth but Connecticut, New Hampshire, and Rhode Island are in the bottom ten. Two of the states with top-performing economies, Arkansas and Nebraska, are among the fastest dozen states. States with low-tax, low-spend governors are on the top and bottom of the list.

In some states, there is reluctance to accelerate contracting without matching funds in sight. Temporarily borrowing the match from the federal line of credit apparently seems too adventuresome for some state officials because they would have to cut back spending later to make up the match. Some officials are seeking additional money from their legislatures, the explanation for Alabama's slow response. Some legislatures and governors probably haven't pushed their highway agencies to accelerate construction.

In a recent speech, Secretary Card urged county officials to light fires under the state agencies in the lagging states. By releasing the comparisons, he lit a few fires himself. The timing couldn't have been worse than in Michigan and New York. While Card was releasing figures showing they lagged behind the national average, their governors were pushing new bond-funded infrastructure proposals as economy-stimulating measures.

There is plenty of blame to go around on the question of accelerating highway projects. In January, North Carolina's Governor Martin complained that many highway projects were being delayed by "unnecessary stagnation" in federal permit processes. He estimated that $83 million worth of North Carolina projects and billions nationally were unnecessarily tied up in the processes. He suggested methods, such as use of arbitrators for minor disputes, to speed them up.

The Congress is also to be blamed for the interaction of a decision on a Brooklyn courthouse and the highway program that has tied up federal matching money. Senator Moynihan (NY) who sponsored the courthouse legislation calls it a "Kafka-esque situation."

SMOKESTACK CHASING ISN'T DEAD

Introduction: "Smokestack chasing" is the pejorative phrase used to refer to aggressive attempts by state and local governments to draw jobs by relocation from other areas and by obtaining new plant investments. It has no rigid definition, but is typically applied to the work done by industrial developers as they identity prospects and present the merits of their local areas. The alternative is said to be avoiding ruinous industrial development competition while favoring strategies oriented toward education and infrastructure. The usual state response to these types of second and third waves of development thinking has been to adopt them, *without reducing efforts at traditional industrial development.*

Competition Stiff: The immense state and local costs associated with the United Airlines maintenance base, the Northwest Airlines deal, the McDonnell Douglas bidding, and the supercollider suggest that the competition in pure smokestack chasing is becoming stiffer, not more relaxed. Neal Peirce concludes in his syndicated column (12/22), "Never have the sums been so colossal; nor, the perils to the taxpayers so great." He quotes a business location consultant:

> *Every governor and mayor elected in the last four years has promised new jobs and development and hasn't been able to deliver. They're caught between a rock and a hard place. They have to bid on the jobs.*

Smokestack Chasing, Mississippi Style: In most chronicles of industrial development, Mississippi is given credit for originating and popularizing the concepts of having teams of developers visit officials of manufacturing companies and offering tax abatements for new facilities. More recently, the state has been used as an example of shifting from traditional concepts to new waves of development ideas.

The new governor, Kirk Fordice, won last November on a platform that included strong opposition to new taxes and added state spending. So far, he has continued that approach despite arguments that education is seriously underfunded. He concedes that improving education is a key to development, but says the state doesn't have the "luxury" of waiting for results: "It takes 10 to 12 years of concerted effort to make a noticeable difference in an education system. We obviously don't have 10-12 years to wait on jobs."

He has pledged to devote substantial portions of his own time to talking "CEO to CEO" to top executives of companies that might locate facilities in Mississippi. He also wants the latest tools in development recruiting:

> *The prospect comes in, states his requirements. You plug them in and do a printout and say, "These are the communities that fulfill your requirements. There's a helicopter outside. Which one do you want to look at first?" That's actually happening in states we compete with. I'm determined to get that going here.*

New War Chest In Virginia: In late March, Governor Wilder signed legislation that gives him a "deal-closing fund" of $4.5 million. The governor can commit the money without legislative action, though he is required to consult with the heads of the appropriating committees in each House. The advantage, according to the Governor:

> *During a period of tight budgets and scarce resources, this fund will allow Virginia to provide that extra touch that might do the trick in luring new business and commerce.*

Reviving Smokestack Chasing In Ohio: Shortly after his election, Governor Voinovich established an operations improvement task force headed by a Cleveland banker and backed by half a million dollars in private money and 250+ private sector volunteers. The group concluded the Buckeye State's development agency's mission is "to assist in retaining and expanding business already in Ohio, attracting new business to the state, and promoting Ohio exports." It recommended the agency: (1) concentrate on this goal, (2) eliminate some newer approaches to development like a seed development fund for university research and seven small business innovation research and technical innovation centers, (3) make management improvements including setting clear goals, and (4) if the goals aren't met in several years, "contract out the Business Development Division to a private non-profit organization with a board appointed by the governor."

Smokestack Saving: In an environment of industrial retrenchment, the logic of smokestack chasing dictates trying to save industry already in place so cutbacks in multi-state firms take place somewhere else. In the lag between GM's announcement that it would close several auto plants and the designation of the plants, there was intensive effort by some states and communities to stay off the hit list.

GM contends: "The plant decisions were based on internal factors and the economic realities of the world automotive market. Political considerations were not part of our decision process." This didn't prevent actions such as designation of the "Texas Commitment" to keep a plant open by guaranteeing Texas purchases of alternative fuel vehicles from GM and tax and zoning concessions that were part of the local county and city effort to keep its plant at the expense of one in Michigan.

Many state and local officials as well as business leaders don't like these special deals, but endorse them anyhow. An editorial comment by a leading Texas newspaper (Austin American-Statesman (1/7) indicates the ambivalence:

> *Offering some companies fiscal advantages not available to others is bad public policy.*
>
> *Unfortunately, in the case of General Motors, the state has no choice. Too much is at stake.*

TECHNICAL NOTES

Tough Times, Tough Choices: Two other aspects of tough choices appear in Issue 5: (1) fiscal moderates facing a short-term problem requiring immoderate tax increases or sharp cuts when their solutions, like rainy day funds and improved budget procedures, are long term and (2) uniquely difficult problems in New York because of unusual constraints on raising taxes, borrowing money, and cutting local aid.

Public Opinion. Changes In The Legislatures (Midwestern Office, Council of State Governments, 641 E. Butterfield Road, Lombard, IL 60148) is an easily read combination of statistics and comments by Midwestern legislative leaders about changes in legislative tenure, professionalism, and challenges. The exit poll results appeared in the Washington Post (3/18 and 3/19) as did the poll on middle class tax cuts (3/19). The Illinois Policy Survey results are summarized in Illinois Issues (Feb.). The Montana Poll was reported by the Great Falls Tribune (12/22/91); the Kansas poll, by the Wichita Eagle (1/19).

The health survey for the Advisory Council on Social Security (200 Independence Ave., SW, Washington, DC 20201) is summarized in its final report, Commitment To Change. A good compilation of opinion on national health care issues appears in The American Enterprise (Mar./April). The graphic was developed by **Reports** from a January poll done for the Health Insurance Association of America. The question was: *Let's assume for a minute the government did decide to get involved to try to provide health insurance coverage to the 30 or 40 million people who currently are not covered. To assure that all Americans had health insurance coverage, would you be willing to pay as much as ...?*

Respondents were given a listing of choices (e.g., $200-400). The graphic is based on the assumption that 35 million people would benefit from the plan, that no added money would be used to cover gaps in existing plans, and that coverage extension would cost $2,500 per person. Respondents were presumed to be making statements about willingness to pay that would generalize to about 150 million adults, but not children.

The approval ratings chart was derived from polls reported in The American Enterprise (Jan./Feb., 1992). Because of differences in timing, samples, and question wordings, using the chart to compare governors of different states isn't appropriate. These problems don't affect comparing popularity of governors of one state at different times.

Safety In The Workplace: The study was developed by the National Safe Workplace Institute (122 S. Michigan Ave., Chicago, IL 60603). The review copies used a long title, Basic Information On Workplace Safety & Health In The United States, 1992 Edition, Including A State-By-State Analysis & Profile, which might be improved upon in the final version. The Presidential campaign has stimulated interest in comparisons of Arkansas with other states in many dimensions. Business Week (2/10) uses rankings from several different organizations to conclude that Governor Clinton's "probusiness record as governor runs counter to his rhetoric."

Legal Challenges To State Taxes: For background on taxing mail order sales and state-by-state estimates of revenue potential, see the Advisory Commission on Intergovernmental Relations (Washington, DC 20575) study, State Taxation Of Interstate Mail Order Sales and the Commission's Intergovernmental Perspectives (Winter 1992). A reversal of the "welcome stranger" aspects of Proposition 13 would trigger a wide-ranging reappraisal of California tax policy with options described in the California Assembly Office of Research study, Legal Challenges To Proposition 13.

Corrections, Amplifications: The trouble with computerized "cut and paste" compared with the manual method is that overlooked scraps go to electronic heaven rather than resting on the table as reminders to stick them in someplace. This was the fate of the technical note to the 50-state table on persons without health insurance that appeared on p. 14 of Issue 4. The data came from the Employee Benefits Research Institute (2121 K St. NW, Washington, DC 20037) -- a competent source of information and further referrals on employee benefits as well as the lack of them.

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STATE
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VOLUME 10 ISSUE 8

IN THIS ISSUE

Under pressure to do more to encourage development, state officials are looking for improved strategies. But many important decisions are being made deal-by-deal in multi-state competitions. Companies may try to appear more footloose to share concessions made to mobile firms.

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- Selecting Development Strategies p. 3
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Assessing how successful state strategies have been isn't easy because so many other factors affect job growth.

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State officials seek new ways to raise revenue without "raising taxes." Calling a tax increase a spending cut is popular this year.

- Revenue Enhancement p. 12

Child welfare programs are costing more but may be producing less as courts play an increasing role in determining state programs.

- Children As Wards Of The States p. 17

From states that have concluded their legislative sessions comes evidence that legislators found their achievements slight, their working environment unsatisfactory, and their job satisfaction so low that many will opt not to seek reelection. Not just legislators are unhappy with the jobs they are doing. Voters aren't impressed either.

- Legislative Frustration, The Early Returns p. 19
- Public Opinion p. 21

Miscellany covers a setback to controlling corrections costs, preparing for economic recovery, and legislative banks. Technical notes detail many sources, few caveats, one error, and one omission.

- Miscellany p. 22
- Technical Notes p. 24

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April 1992 (Second Of Two April Issues)

THE ECONOMIC DEVELOPMENT PRIORITY

Economic development remains a popular theme for state elected officials of all political persuasions. It is the key to solving two persistent major problems -- constituents without jobs and state revenues that don't grow fast enough to cover current spending. Economic problems are constantly put in front of everyone by the media. Debates over economic problems and their solutions are a major part of the Presidential campaign. Development unites welfare recipients blaming problems on lack of economic opportunity, blue-collar workers fearing layoff, and millionaires facing bankruptcy.

The Public Likes Jobs: Polls confirm the widespread concerns. ABC News found a steady increase in Americans describing the state of the nation's economy as "not so good" or "poor." That percentage was 91% in December, up from 53-60% in the late 1980s. A survey late last year shows that nearly 35% of Michigan residents identified jobs as the most important issue. The next highest concern was crime and drugs (just under 20%), followed by education (12%). Topics scoring under 10% (from more important to less) included the state budget, property taxes, assisting people in need, the environment, access to health care, ethics of elected officials, insurance rates, and abortion.

Governors Like Jobs: The state-of-the-state messages illustrate the emphasis. In South Dakota and Wisconsin, where economies are doing well, governors devoted their messages to touting the results and exhorting legislatures to do more and better. In states suffering most, the governors typically bemoaned the situation and presented proposals to make things better. For example, in Maine, Governor McKernan linked the themes of austerity, tax increases, and development. He told legislators:

> *On every vote you cast this session, you must ask yourself two basic questions. First, "Will this help save or create jobs?" And second, "Can we afford it?"*

Legislators Like Jobs: Before the legislative sessions are complete, many new development measures will have been passed. The recent special session in Arkansas may be a sign of the predatory times. Arkansas officials were aware of reports that aerospace firms were dissatisfied with their California location. The response was the Arkansas Aviation and Aerospace Commission with $10 million to seek aerospace-oriented firms. This kind of money won't lure Boeing from Seattle, but could loom large in location decisions of aircraft component suppliers.

Despite a fiscal situation that didn't permit salary and state aid increases large enough to cover inflation, New Mexico legislators passed many new development initiatives this year. They too now have an aerospace supplier program. There is more money for stimulating development across the board and new special incentives for oil production, coal production, and film-making.

SELECTING DEVELOPMENT STRATEGIES

> *If the states are to successfully navigate the turbulent transition from the conventional to the emerging economic paradigm, they will not only need sound economic theory and an effective economic strategy. They will also need* ***institutional change strategy*** *that, more like a compass than a road map, points them in the direction of the emerging paradigm, and moves them forward at a pace and with a surefootedness appropriate to the uncharted territory they are attempting to traverse.*

Developing The Policies: These comments from Scott Fosler (Committee for Economic Development) reflect the common view that states can do a better job of managing development strategies.

This concern is particularly salient in the states that go beyond smokestack chasing and deal-making crafted to suit needs of individual firms with attempts to meld public schools, higher education, manpower training, tax policy, and other policies into a unified state-local strategy. Economic development agencies traditionally aren't given authority to make policy across this broad spectrum. As a result, there is inherent dissatisfaction that states don't have coherent economic development strategies.

Unwilling to turn day-to-day control of such functions as making tax policy and educating youth to development agencies, state officials turn to task forces, blue ribbon commissions, and special reports for advice. As a result, there is a continuing flow of reports on state development strategies. These typically: (1) assess trends and problems in the state's economy, (2) identify industries that offer the greatest potential for development, and (3) consider strategies for enhancing investment and recommend those appearing most promising.

Typical Development Strategies: The vocabulary of the studies is changing over time, though the substance is not. For example, in Arizona's new plan the concept is *strategic planning*, the target industries are *clusters*, and the strategies dealing with infrastructure, worker training, and tax policy are *foundations*. Exogenous employment sources that sell to national and international markets are *high-value industries* with subcontractors in *supply industries*. Endogenous local employers like grocery stores and gas stations are *population-driven* industries.

The recommendations for Arizona closely resemble those of similar reports in other states. They include better education at all levels, a healthy supply of business investment capital, improved quality of life, more infrastructure (including communications), university research and technology transfer, regulatory streamlining, stable and competitive taxes, and tax incentives for business development.

Looking At Failures And Problems: In California, considerable effort is going into attempts to diagnose the sources of the state's economic problems. There have been studies by the legislature (Assembly Office of Research), business associations, a utility, and various academics. The concept is to identify sources of dissatisfaction by firms currently in California, particularly those that have chosen to make their expansion investments in other states.

In less populous Rhode Island, similar introspection is occurring. It is easier because fewer firms and industries are involved. For example, the problems of Electric Boat -- the contractor for the Seawolf submarines that may be cancelled -- are the subject of considerable debate in Congress. Less well known is the competition within the company between its larger facility in Rhode Island and one in South Carolina. The company contends that lower costs in South Carolina make it hard to direct new commercial work to Rhode Island. They cite wage rates, Workers' Compensation costs, and utility charges.

In the mid-1980s Rhode Island produced one of the most comprehensive state economic development plans ever developed, the GREENHOUSE COMPACT. Voters rejected implementation of the $250 million plan.

INDUSTRIAL DEVELOPMENT ADVERTISING

Most states advertise in business publications to publicize their advantages as a place for business to locate. Often there are inserts combining state pitches with those from local utilities, railroads, and local governments -- melded with ads from in-state companies that pay for the magazine space. The pitch made in these advertisements merits occasional review to indicate what state economic development officials see as important. If one state is advertising a public policy considered attractive to business that a second state lacks, it is a good bet that economic development professionals are lobbying for the policy in the second state. This article summarizes recent ads.

Iowa (*The Smart State For Business*) touts high college entrance scores, higher-than-average productivity, and a high graduation rate. Much of its pitch is oriented toward taxes: (1) a "non-unitary" tax that allocates 100% of corporate income on the basis of sales, so there is no Iowa income tax on profits from out-of-state sales, (2) deductibility of federal taxes from corporate income, (3) no sales tax on machinery and equipment, (4) no personal property tax, (5) R&D credits, and (6) "the nation's lowest new employer Unemployment Insurance rate." **Nevada** makes its tax case more simply -- "no corporate income tax, no personal income tax, and the lowest overall tax rates in the nation." It also cites low housing costs, location, transportation, and "the state's pro-business attitude." —

Alabama (*A Perfect Place To Raise A Company*) offers: (1) internationally recognized state universities, (2) computing and creative arts in the schools, (3) over 28,000 miles of glass fiber optic cable communications, (4) free job training, (5) warm climate, (6) "an umbrella of laws -- including one of the strongest tort reform packages in the nation -- to provide a more profitable environment for business and industry," and (7) no property tax on inventories, raw materials, and goods in process. One **Alabama** ad describes the Alabama Resource Center, an aid to site selection including a laser disc system allowing access to a video-disc catalogue of 52,000 Geological Survey maps. **New Jersey** (through a utility company ad) emphasizes its high-tech workforce, location, and transportation and notes its per capita income (#2 of 50 states) and bond rating (AAA).

Georgia, fulfilling a commitment of state leaders to try to encourage development outside the Atlanta area, describes the virtues of other communities and firms already located in them. The **Pennsylvania** advertisement concentrates on location and transportation, but says the state offers "a superior quality of life, a skilled and dedicated work force, and financing programs that reinforce our productive business climate." **Maryland** emphasizes its attitude toward business and state programs like its job training program and venture capital fund. It cites its straight A rankings from the Corporation for Enterprise Development.

Wisconsin uses photos of press reports indicating the state's economy has been thriving in recession. It brags on its business climate ranking, low energy costs, a low cost of living, impressive success rates among business start-ups, and "business taxes that are the fourth lowest in the country." **North Carolina** cites its consistent #1 ranking in gaining new manufacturing facilities. The success is attributed to: (1) a productive well-trained workforce, (2) "right-to-work industrial climate," (3) lowest-in-the-nation construction costs, (4) the transportation system, and (5) "some of the most hospitable communities and diverse recreational opportunities you'll find anywhere."

Arkansas just uses a long endorsement of the state's workers, location, transportation, and business-government relations from the head of Wal-Mart Stores. The decision by a plastics manufacturer to expand in **Missouri** is the basis of the state's pitch for its location, "traditional work ethic," and "pro-business climate." To seal the deal, "Missouri offered site incentives, tax incentives, new infrastructure, and a customized job training program." **South Carolina** advertising is also centered on success in the state by a single firm, Hughes Aircraft in one ad and safe-maker Mosler in another.

Florida calls people "a company's #1 asset in Florida" and promises to show "how better living conditions can improve productivity in the workplace too." **Arizona** focuses on its highly skilled and motivated labor force, a commitment to education, a lower cost of doing business, good location, and "a government that understands and values your business -- and you."

FIGHTING IT OUT, DEAL-BY-DEAL

In theory, most state officials would probably prefer to implement a development strategy reflecting coordinated application of state and local resources, consistent choices of cost-effective incentives, and even-handed treatment of similarly situated firms. In practice, decisions on what incentives to provide under what circumstances are being made case-by-case.

Among other things, this means that state officials are "picking winners," to use a phrase popularized by critics of a national industrial policy. They are deciding among firms making claims that their businesses will prosper and create large numbers of new jobs. They are backing their picks with partly retrievable investments in land, utility connections, and tax abatements. Increasingly, they are backing their picks with cash outlays in the form of risky loans and equity investments that are unlikely to be recaptured if their picks are wrong.

There are three effects of this firm-by-firm, investment-by-investment approach: (1) lots of deals being made, (2) gains to be exploited in some cases, and (3) losses to be taken in others. An unintended consequence is that firms that aren't considering relocation need strategies to try to match two forms of concessions: (1) ones offered by their home state to other firms not their competitors and (2) ones being offered by other states to their footloose competitors.

Legislators Picking Technological Winners -- Utah

Perhaps the best example of technological risk-taking was Utah's decision to support "cold fusion" research at the University of Utah. The concept is to use the principle of the hydrogen bomb to generate electric power. If feasible, such a development could revolutionize energy supply, making the burning of coal and oil for power supply unnecessary. The idea has many skeptics, who view it as the equivalent of the perpetual motion machine. University of Utah scientists gained nationwide headlines in the late 1980s when they announced that their experiments were generating significant amounts of power. Controversy erupted quickly as other scientists said they couldn't replicate the results.

In this obviously risky environment, Utah appropriated $5 million to support the research without any gimmicks -- no backdoor funding, just a normal appropriation. It was fully understood in the legislature as a bet on the technology and its potentially favorable impact on Utah from being the center of development of the power source of the future. A long period of uncertainty followed with episodes like not being able to find the researchers, other researchers not being able to replicate results, and finally a Utah decision last year not to support the research further.

Somewhat ironically, this line of research is being continued (at SRI International in California rather than in Utah) by the Electric Power Research Institute. The Institute gets its money from electric utilities that recover the costs from customers in state-approved electric rates.

Lots Of Deals Being Made

No one can systematically track the concessions being made daily by state and local governments to lure and keep footloose job-generating firms. The offers that aren't accepted remain confidential. Successful offers aren't systematically reported to any central source. Anecdotal evidence suggests that the stakes are large and growing.

The McDonnell Douglas plan for a new aircraft manufacturing plant may never materialize, but it won't fail for lack of state and local interest. Alabama, Arizona, Illinois, Louisiana, Missouri, Oklahoma, Texas, and Utah are all in the running. Significantly, California, where the company now has production facilities, is not. The bids are said to offer several hundred million dollars in concessions and direct aid each, implying costs-per-job in the $30,000 to $50,000 range. This can be divided by two if each job associated directly with the plant has a multiplier providing one additional local job.

Because of a depressed commercial real estate market, companies with the capacity to move office work from one state to another have massive leverage. One of the most striking recent deals concerns the new glass tower on Times Square in New York. The mortgages on the new unoccupied building, presumably less than its total cost, total $250 million. It is being sold to Bertelsmann A. G. (RCA Records, Bantam Doubleday Dell publishing, and more) for $119 million. The former equity owners lose their investment while mortgage holders take a massive bath. New York City kicks in a package valued at $11 million by exemptions from sales taxes and capping the increases in real estate taxes associated with property improvements.

If one believes reports that the company was considering the move of 500 employees to Chicago and/or Indianapolis, a move to be precluded by a contract with the city, the city's investment is $22,000 a job. The New York Times (3/4) reported that the size of the city's offer surprised real estate experts as the jobs belonged "to a company that was not threatening to leave New York."

Not just money is involved. Press reports indicate that Utah legislators have redrawn Congressional district boundaries to ensure that a particular representative who often clashed with McDonnell Douglas wouldn't be representing the territory where its plant might be located. Concern with development motivated New York to loosen state restrictions on credit card terms and interest charges.

Development considerations are constantly pitted against environmental protection regulation. There have been major issues recently in the Carolinas, Maine, Texas, Virginia, and other states. Development concerns have been used to argue for both loser regulation of banks (so outside banks will come in) and tighter regulation (so outside banks won't swallow local ones). Some states have changed their laws on corporate governance (e.g., powers of shareholders in conflicts with management) as economic development measures.

Exploiting Gains

There are few recent success stories from state development efforts. One is United Airlines' decision to locate a maintenance base, with as many as 6,000 jobs, in Indiana. The governor estimates that the facility will generate $500 million in new tax revenues over and above the $172 million the state is providing as incentives. He recently announced education investments to train Hoosiers for the new jobs. The graduation rate of certified aviation mechanics will be stepped up to 425 a year from about 185 currently. Purdue University will begin to offer degrees in aviation administration.

Taking Losses

State and local governments can easily be left holding the bag from industrial development investments. In some cases, as in venture capital funds and speculative development of industrial parks, the state's potential losses are known at the outset.

In "bird in the hand" industrial development financing, the investment appears less speculative because it is tied to specific decisions by a firm to make investments of its own. But when a firm is willing to write off its own investments, it is also writing off the state and local investment.

One old example was the pioneering action by Pennsylvania to draw a Volkswagen plant. The plant was closed long before the useful life used in justifying the state's investment. Similar situations are arising with considerable frequency as recession stimulates companies to prune older production facilities and competition washes out new firms backed by state venture capital.

With stakes in the financial viability of firms that owe state agencies money as well as employ state residents, **state officials are increasingly confronted with decisions about whether to put additional money into troubled firms.** The fear is throwing good money after bad. The hope is that more capital will enable fundamentally sound firms facing temporary adversity to survive.

Two years ago, Colt's Manufacturing Company, maker of the famous Colt 45 pistol, was in danger of failing. The bailout was to buy the company from its parent, with Connecticut pension funds putting up $25 million and taking a 47% ownership share. In March, the company filed for Chapter 11 bankruptcy. Its petition indicated it had a negative net worth of $9 million. This would mean if the company were liquidated, stockholders, including Connecticut, would receive nothing. The governor announced that the state will guarantee $2 million in loans as part of the effort to keep the company operating.

Looking At Firms That Won't Move

The impact of stiff industrial development competition is not captured by examining concessions now being made for identifiable plant location decisions. **Firms with no immediate location decisions to make are using the possibility of locating elsewhere as leverage over state and local policy.**

Boeing is a good example. Boeing competes with McDonnell Douglas and Airbus Industries, a government-subsidized European firm. Boeing is locked into the State of Washington for current production and for the new 777 jetliner. Sometime, probably in the next century, there will be a new plane, perhaps a 600-800 seat one that would justify building a new production facility. Until then, Boeing is considered immobile, though it can vary where components are produced among its Alabama, Kansas, and Washington facilities and subcontractors elsewhere.

Not to be taken for granted, Boeing's chairman addressed the company's concerns about high costs of doing business in Washington in a Chamber of Commerce speech in December. He told his Seattle audience that company studies indicated that expansion in Wichita or Huntsville would be 30-40% cheaper. He concluded that Boeing wasn't considering relocation, "But the necessity to stay competitive in the world market demands that we consider these costs as a significant factor in our plans to accommodate additional growth." In a comment quickly noticed in Seattle, the company's local plant manager told the Wichita city council that Wichita was a "frontrunner" to get the assembly plant for the next generation of jetliners.

State interest in the problems of firms already located in their state isn't just a matter of responding to the large and sophisticated staffs like those Boeing can devote to pubic policies of the State of Washington and its local governments. For example, a part of the Rhode Island economic equation is the jewelry industry, a cornerstone of the state's manufacturing base. This highly fragmented industry is in serious trouble. It doesn't need threats of moving. Many of the small firms that dominate the industry can't credibly make them. The problem is they may close Rhode Island plants because they lose out to competitors elsewhere, not that they will move.

This situation, and similar ones in other states, argue against tilting state policies to improve the competitiveness of one major employer like Electric Boat's Quonset Point shipbuilding facility. Rhode Island could systematically reduce Electric Boat costs by shifts in how it allocates utility costs among customer classes, its experience rating and payroll base in Unemployment Compensation, and its insurance plan features for Workers' Compensation. But shifts from the high visibility submarine maker to the low visibility jewelry companies and their counterparts in other industries might be counterproductive.

MEASURING SUCCESS OF DEVELOPMENT EFFORTS

Enthusiasts for state development programs and incentives often have success stories to tell, but it is hard to assess the extent to which the success was caused by the state activity. In some areas, like export promotion, it is plausible that state efforts in the aggregate lead to better national performance. In other areas, such as attracting investments in warehouse facilities and food processing, it is clear that the jobs would exist somewhere in the U.S., making development a zero-sum game.

Merely because the game is zero-sum doesn't mean it shouldn't be played, so legislators can appropriate development funds with the same gusto they bring to such zero-sum games as determining who gets the best general admission seats or which states have the best athletic teams or physicists. But if those spending state money for development defend their work based on beating competitors, legislators will ask for the equivalent of sports standings -- data on how well they are doing relative to the competition.

The information available on how states are doing isn't helpful in showing how state development policies are doing. Those development efforts are only a part of the total aspect states present to business, including labor law, tax policy and more. And these are only a part of the total state environment which includes uncontrollable factors like climate, location, and raw materials. And these are only a part of the jobs picture which is heavily influenced by changes in technology and consumer preferences, international competition and U.S. trade policy, and more.

Considerable effort goes into academic studies to assess the impact of state development efforts. Two recent ones illustrate the problems in using the results as a guide for state strategies.

A statistical assessment finds that larger state export promotion budgets are associated with smaller total exports. Other things being equal, more staff seems to be better than less. But how many overseas offices are maintained doesn't make any difference. A recent assessment of the correlation between public infrastructure investments and the growth of manufacturing productivity suggests the "link is weak." Other studies have produced the opposite result.

Reading the academic studies isn't for everyone. Readers need to know that a *dummy variable* isn't an ill-informed legislator vacillating on how to vote. To assess the export study, readers should have an opinion on whether, when faced with heteroskedasticity and auto-correlation, they should abandon OLS and turn to LSDV or GLSE. {If you thought that sentence was about what drug to take after dealing with sex deviation situations, you may want to consider whether university research on public policy is doing anything for people making state policy decisions. -Ed.}

Job Growth And Decline

The numbers of new jobs that state officials announce as associated with new corporate plants and expansions have two massive problems: (1) many of the announced jobs never materialize and (2) the numbers don't reflect jobs lost by plant closings and contractions.

In broad overview, the critical numbers are the changes in total employment in each state (see Issue 6). However, they can be highly misleading because they reflect booms in construction and real estate that may not be sustainable. They also include jobs in service industries, retailing, and state and local government that cannot be sustained without a strong economic base. That base comes from what economists call *exogenous* economic activity, business created when in-state firms sell to national and international markets rather than when residents sell to each other.

New plant announcements, broadly defined to include transportation and distribution facilities as well as manufacturing plants, provide one indicator. There were 3,084 such facilities announced in the U.S. in 1991. Six states dominated -- Florida with 281, North Carolina with 276, Texas with 261, California with 191, Alabama with 156, and Kentucky with 152 -- together accounting for 42% of the national total. The winners list changes considerably when the number of new facilities is related to state population as is done on the table.

New Corporate Facilities And Expansions Per Million Population, 1991

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Mississippi	49.0	18	Missouri	14.5	34	Idaho	6.7
2	North Carolina	41.0	19	South Dakota	14.2	35	California	6.3
3	Kentucky	40.9	20	North Dakota	12.6	36	New Jersey	5.8
4	Alabama	38.2	21	Kansas	12.4	37	Maryland	4.9
5	South Carolina	26.4	22	Alaska	12.3	38	Illinois	4.9
6	Oklahoma	25.8		**United States**	**12.2**	39	Michigan	4.9
7	Indiana	22.5	23	Utah	11.3	40	Minnesota	4.5
8	Florida	21.2	24	Louisiana	10.3	41	Rhode Island	4.0
9	Nevada	20.2	25	Delaware	10.3	42	New York	3.5
10	West Virginia	20.0	26	Ohio	9.6	43	New Hampshire	2.7
11	Arkansas	19.8	27	Washington	9.6	44	Pennsylvania	2.5
12	Iowa	18.2	28	Arizona	9.1	45	Massachusetts	2.5
13	Georgia	18.0	29	Wyoming	8.7	46	New Mexico	1.9
14	Virginia	17.0	30	Oregon	8.2	47	Vermont	1.8
15	Tennessee	16.8	31	Colorado	8.0	48	Connecticut	1.2
16	Wisconsin	15.1	32	Hawaii	7.9	49	Maine	0
17	Texas	15.0	33	Nebraska	7.5	49	Montana	0

Southeastern states clearly dominate the list. They hold the top five positions, all of which are more than twice the national rate. Traditional industrial states of the Northeast and Midwest and California are all below the national average. Small states generally do badly, even when the comparison is made on a per capita basis. Seven of the ten least populous states are below the national average while the other three, the Dakotas and Alaska, are barely above it. Looking at a broader time horizon, announcements in the past three years rather than the past year, doesn't change the pattern of Southeastern dominance. The exception is Nebraska which is #2 on a three-year basis. The other states in the three-year top five are Alabama (#1), Mississippi (#3), North Carolina (#4), and Arkansas (#5).

All states are losers in drawing investments in giant plants. Only one of the ten most costly facilities -- all representing an investment of at least $1 billion -- is going to the United States. It is the United Airlines maintenance facility slated for the Indianapolis area. The five largest, all over $1.5 billion, are a Ford/Volkswagen plant in Portugal, a steel mill in Malaysia, and giant petrochemical plants in Taiwan, China, and South Korea.

REVENUE ENHANCEMENT

With state officials desperate to find election-year ways to avoid raising taxes without cutting spending, there is considerable pressure to use easy solutions. Examples are: (1) reducing retirement contributions by assuming greater return on investments or changing actuarial methods, (2) delaying spending into the next fiscal year, (3) selling and leasing back assets, (4) borrowing short term, and (5) shifting spending from the general fund to other funds, particularly to bond funds. Much of this inventory of ideas for apparently painless lowering of spending has now been used.

Because these ideas provide one-time financing for ongoing spending, like school aid and employee pay, they are inherently addictive. Each use requires subsequent use of equal or larger quantities. The alternative is painful withdrawal. Sophisticated players in fiscal politics recognize this and know that withdrawal will cause an unpredictable mix of higher taxes and cuts in major spending flows, such as education. As a result, taxpayer groups, business leaders, and education interests all become increasingly nervous over reliance on easy, but one-time, fiscal fixes. Bond ratings, which have been declining, and warnings from rating agencies, which have been increasing, provide barometers of concerns.

So the search for painless budget solutions focuses more and more on raising multi-year revenue flows. Most mechanisms are well-known, but there are new twists.

A Tax By Any Other Name

Phrases to describe raising taxes without saying so don't stay current long because they quickly become objects of derision. This is becoming the fate of *revenue enhancement*. One device in use this year defines sales and personal income taxes as *general taxes* or *broad-based taxes*. Increases not affecting them are implicitly treated as more acceptable because they don't involve increasing general or broad-based taxes.

"Not a tax, but a *contribution*" was what Governor Wilder called the health provider gross receipts levy he unsuccessfully urged this year. Governor Thompson, who appeared with him on CNBC-FNN (3/18), accepted this phrasing as they attributed problems in Virginia and Wisconsin Medicaid budgets to federal decisions, particularly mandates. The use of *contribution* for provider taxes is natural for governors seeking to replace provider donation programs (soon to be unacceptable under new federal rules) with provider taxes. However, it hasn't been persuasive with the many people not familiar with the history of Medicaid financing. A mandatory levy on gross receipts that is characterized by opponents as a "sick tax" just doesn't sound like a donation.

Revenue enhancement is rapidly being replaced by *loophole closing* as a way to describe tax increases. This usage is common to characterize broadening of the sales tax base. In appears in connection with other proposals based on the concept that a particular group isn't paying a fair share, such as very high income taxpayers who pay the same top bracket income tax rate as middle income taxpayers.

Fee Increases

> *It's a fee increase and it's a revenue enhancement process, so you might as well call it a tax increase.*

Comments like this are common in states where governors are seeking to maintain a posture of not increasing taxes while simultaneously enhancing revenue collections. The quote is from the speaker of Michigan's House during extensive March debate on fee bills that are part of the mechanisms to balance the FY 1992 budget. The legislation will raise $0.4 million annually through food service license fees, such as doubling to $2 the fee for vending machines.

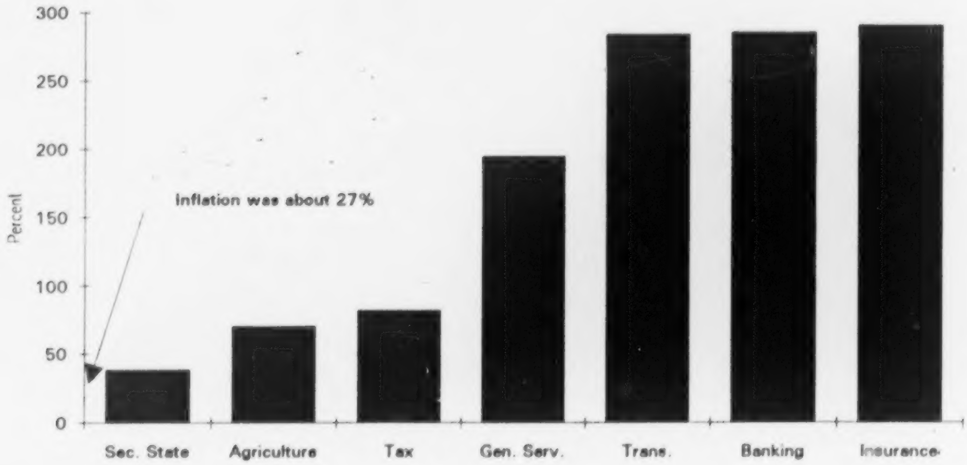
Florida has been particularly active in the use of new fee concepts. It pioneered in the use of impact fees of several hundred dollars for registering vehicles that don't replace ones previously registered in the state. Georgia copied this device this year. Florida's one cent fee on bottles and cans is scheduled to go into effect in October. A recent calculation by Dade County contractors concludes fees per square foot of warehouse construction have gone from nine cents in 1988 to $1.35 this year.

New ideas continue to emerge. Maine's legislature considered a $2 fee on cats to finance animal welfare programs, but backed off quickly after public protests. Some New Hampshire communities are assessing drunk drivers for the costs of their arrest and prosecution. California's supreme court recently decided that school districts can charge parents for bussing children to school. A proposal in the Pennsylvania legislature would assess marchers and demonstrators for the costs of police protection, including that necessitated by any counter-demonstrations.

The private sector has been quick to use automatic billing through phone numbers as a way to sell services. The 900 concept has spread beyond Dial-A-Porn to ways to get sports news and weather from your local newspaper and financial information from the Wall Street Journal. In a question and answer period following a speech by **Reports** editor Hal Hovey to a business group, this exchange occurred:

> ***Question***: Recently our state has begun to use 900 numbers for providing information held by the state such as registration status of corporations. Is this common? Is it a trend?
>
> ***Answer***: I am not aware of this as a trend, but it could be happening. I can see why the concept might be attractive to some state officials. So I'll mention it in **State Policy Reports**, which may make it a trend.

The chart shows trends in fees charged businesses by New York State agencies.



Percent Increase In Business Permit Fees
New York State, FY 1985 To FY 1991

The smallest increase of 38% was well above overall consumer price increases of 27%. The worst news came from increases too large to show -- 1,241% in Labor Department fees and a 2,161% increase in environmental permit fees.

Professional License Charges

Taxing professional services is an important issue, but a sales tax on the service may not be the vehicle. **There is increasing interest in taxing licensed professionals by a direct tax on them associated with holding a license.** The traditional license fee is set at a level consistent with the state's cost of maintaining the paperwork of the licensing process, paying licensing boards and their staffs, and conducting disciplinary proceedings. In some states, there are additional levies associated with covering losses associated with misconduct in the profession (e.g., lawyers and real estate brokers who abscond with client funds) and/or with extension of that profession's services to those unable to pay (e.g., indigent criminal defense).

There is no limit when going beyond these charges to much higher ones based on registration. Many states tax trucking this way. A substantial portion of truckers' highway user charges comes from vehicle registration -- technically permission to drive on highways parallel in concept to permission to practice law or accounting.

New Jersey opened this door wide with its 1990 auto insurance reforms. To reduce costs that consumers would otherwise see in auto insurance premiums, the state levied additional fees in the hundreds of dollars on some of its licensed professionals, such as health care providers.

The topic is currently a hot one in the District of Columbia. The mayor proposed that professional license fees be based on gross receipts. Fearing that the levies might drive professionals to nearby suburbs and contravene federal law prohibiting the District from taxing commuters, the city council rejected the idea. But it followed the basic concept by increasing the standard professional license fee from $100 a year to $250 a year and increasing the personal property tax on furniture and equipment -- which in the District is primarily a tax on office equipment.

The tax plan recently passed by the Maryland Senate broadened the sales tax to include many consumer services as well as goods (e.g. to snack foods and newspapers) now exempt. It didn't apply the tax to professional services, but did increase the licensing fee for lawyers to $125 a year. This fee didn't survive in Maryland's final bill, but a $200 annual privilege tax is part of legislation recently approved in Tennessee. From A to V, it reaches state licensed professionals: accountants, agents, architects, attorneys, audiologists, brokers, broker dealers, chiropractors, dentists, engineers, investment advisors, landscape architects, lobbyists, optometrists, osteopaths, pharmacists, physicians, podiatrists, psychologists, speech pathologists, and veterinarians.

Packaging Revenue Increases As Spending Cuts

The ultimate in satisfying both those who want to spend more and those who want to cut taxes is to portray tax and fee increases as spending cuts. Describe a tax increase as a spending reduction? This isn't as crazy as it sounds.

Fee increases are already presented as spending reductions in some states and in the federal budget. The result occurs automatically if fee revenue is included as an offsetting receipt within an agency's budget totals. The higher the fee, the higher the offsetting receipt, which appears in budgets as a ***negative expenditure***. These negative expenditures offset positive ones in the net spending totals presented in budgets.

A similar offset occurs in particular funds, like state general funds, if an earmarked tax, like the gasoline tax for highways, is increased and the revenues are used for spending that would otherwise be covered by the general fund. This is not of merely academic interest. A substantial portion of the $1.1 billion *cut* in Medicaid and welfare spending in the newly enacted New York budget comes from *an increase* in revenues from health care provider taxes.

These kinds of shifts have become widespread. They will cause major differences between state spending increases as reported to the press locally and in national surveys by organizations of state officials and the spending increases that will ultimately be reported by the Census Bureau. In simple terms, state spending on an apples-to-apples basis is growing much faster than is currently being reported.

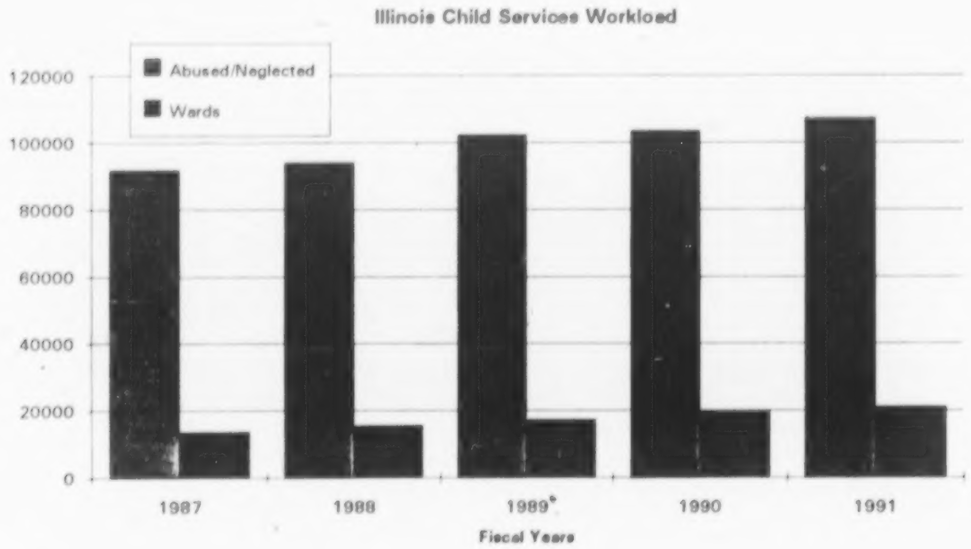
Spending Cuts By Shifts To The Private Sector

There has always been substitution of private effort for cutbacks in public spending, but the movement is voluntary. Expenditures on private security services, private campgrounds, and private schools are to some unknown extent larger than they would be if governments spent more on police, parks, and schools. A more obvious shift is to discontinue a government activity but require essentially the same or more activity from the private sector. This reduces the government spending for the activity while ensuring that it is carried out to standards set by government.

New Hampshire's handling of the weights and measures function shows how the shift works. Like other states, New Hampshire protects consumers from vendor cheating by periodically checking devices used to measure goods sold by quantity, such as supermarket scales and gas pumps. The old practice was for state inspectors to perform this function. The new practice is to require merchants to purchase private inspections and send proofs of the results to the state, along with fees for state employees to monitor the reports.

CHILDREN AS WARDS OF THE STATES

Child welfare issues are a major topic in many legislatures this year. The underlying problem is easily understood, but not easily resolved. One of the results is a rapidly growing workload for state agencies dealing with children. The graph shows the growth in the number of children reported as abused or neglected in Illinois and a continuing increase in children in "substitute care." That category includes children placed by the state in homes of relatives, foster care homes, group homes, and institutions.



Growing public concern over child abuse and an apparent increase in the number of young children of drug-abusing mothers has increased the number of children for whom state intervention may be appropriate. **States are subject to criticism no matter how aggressively or passively they approach these situations.**

An increasing number of natural parents are making widely publicized complaints that the states are unnaturally intervening in the family, inappropriately taking children from their parents, and creating an environment destructive of normal family life. Conversely, there are many well-publicized examples of child abuse and even death stemming from situations in which states didn't act quickly enough to take children away from their parents. Criticized for acting both too quickly and too slowly to take children from natural parents, child welfare agencies tend to leave the children in an in-between status.

One result has been to increase the number of children that have ties to *both* state governments and natural parents. The children may be in temporary custody of welfare agencies, in special homes, or temporary foster care. Or, they may be in the custody of the parent(s) with state involvement such as counseling and monitoring for detection of abuse or other problems. With attempts to restore the normal home setting underway and the natural parents' right to custody not extinguished by legal action, the children can't be placed permanently.

In Massachusetts, for example, there are about 3,500 children at any one time that arguably are candidates for adoption, of which less than a third can actually be adopted. According to a recent internal report on these waiting children, the cost is nearly $40 million a year. California has over 80,000 children in foster care, up from 28,000 in 1982.

The problem doesn't admit to easy solutions, but does tend to spawn studies. In Massachusetts, a study on foster care reported recommendations in 1988 and there have been several legislative reports on the child protection system. Governor Weld has indicated he intends to appoint a study group on these issues.

Child-welfare systems are under attack in the courts in many states. Ten to fifteen states are under some form of court order dealing with the handling of foster children. Arkansas officials decided to switch rather than fight. The major topic in the recently completed special legislative session was implementation of a proposed settlement to a class-action lawsuit. The legislature accepted it with little dissent and an appropriation of $15 million. Illinois settled last year. One result is a 21% increase in the FY 1992 budget for its Department of Children and Family Services.

In Florida, settlement is tied to broader fiscal issues. From a base of $28 million, the governor wants to add $17 million to the FY 1993 budget for emotionally disturbed children in state care -- about 10,000 of them. But this is just one aspect among many that constitute the $1.3 billion in new taxes he is seeking from a reluctant legislature. He recently took the unusual step of making a personal appearance in a federal courtroom, where he successfully sought an agreement that suspends the pending litigation while he works on the legislature to provide additional money.

A late March divided opinion of the U.S. Supreme Court (Suter v. Artist M.) will probably further muddy the legal waters. The decision itself was good news for states. The Court held that individual plaintiffs didn't acquire standing to sue states on foster care issues because of the wording of the federal Adoption Assistance and Child Welfare Act of 1980. Parallel language in the federal Medicaid statute and certain dicta suggested that states may now be in a stronger position to resist litigation by hospitals and nursing homes over reimbursement rates. But many child welfare suits depend upon other state and federal statutes and constitutions, so some observers predicted more, rather than less, litigation in the child welfare field will result from the Suter decision.

LEGISLATIVE FRUSTRATION, THE EARLY RETURNS

> *This has not been a truly significant session. There's been no legislation to turn the hard economic times around, or eradicate educational disparities, or address critical needs or transportation, and it was within our power to do all of that.*

Negative reviews, like this one from Virginia's House Majority Leader, are pouring in as legislative sessions end. Legislative leaders and backbenchers alike report that the sessions are setting records for member dissatisfaction with their accomplishments, their workload and procedures, and the lack of appreciation for their work by constituents.

Virginia (see box) shows the sources of frustration. The test is not whether legislators did "the right thing," but how they felt doing it. Another test is whether what they achieved is a good-enough explanation to a spouse or 10-year-old for long hours away. For citizen-legislators, another test is whether the rewards justified the time off the job.

If It Feels Good, Do It -- Fiscal Outcomes In Virginia

A decision not to raise taxes guaranteed a tight fiscal situation which precluded major initiatives, disappointing those who hoped to make their mark with new programs and better funding for current ones. Strong interest in school finance equalization was converted into a compromise that splits minor new money between poor rural districts and rich Northern Virginia districts to avoid cuts from equalization criteria. Without new money, legislators avoided new education quality measures. In higher education, debate was over whether to scale back past initiatives, like the Center for Innovative Technology, not new initiatives.

Health care initiatives were constrained by the fiscal situation and the need to replace current Medicaid bootstrap financing. The provider tax proposed by the governor was dubbed a "sick tax" by the hospital administrators who opposed it enough to scare off tax-shy legislators. Covering health initiatives by increasing the lowest cigarette tax in the nation drew opposition from tobacco growers and manufacturers. The compromise avoided a state increase but allows Northern Virginia counties to raise cigarette taxes if their voters approve.

Scheduled tax relief for the poor by a sales tax exemption for nonprescription drugs was sacrificed to fiscal necessity. Instead, legislators adopted a tax increase that won't draw much attention, adding sales tax to the prices charged in state-owned liquor stores. A transportation plan with accompanying gas tax increase, which the legislature has authority to enact, became a bond issue, permitting voters to approve the plan and a small gas tax increase in November. The governor vetoed the tax portion and part of the spending because the "mere presence" of a tax increase on the ballot would jeopardize three other bond issues in the same election.

Legislators who judged their performance by downsizing government or reducing spending didn't get much satisfaction out of the session either. There were no dramatic program cuts, instances of privatization, or reorganization of state functions. Much policymaking consisted of finding new ways to finance current activities, not finding less to finance. Examples: reducing retirement contributions without reducing benefits, financing universities with more tuition and less state aid, and financing construction with bond issues rather than general revenue.

One knowledgeable observer, surveying the national pattern of frustration and job dissatisfaction, points out that people run for the legislature because they want to do something. Being cast in the role of nay-sayer isn't comfortable for Democrats or Republicans. Friends from churches, clubs, and neighbors are asking more "Why did you ...?" and saying less, "I think its great that you ..." Less senior legislators, always disappointed to learn that not all legislators have equal power, have their own frustrations. One in Maine has joined the new *mushroom caucus*. According to the Boston Globe (4/5):

> *Freshman Rep. Donald H. Gean did not define just what the mushroom caucus is, but he didn't have to. Disgruntled rank-and-file lawmakers who feel left out of the process often refer to themselves as mushrooms that are kept in the dark and fed what might politely be called horse manure.*

Record numbers of Members of Congress aren't seeking reelection. Some have issued statements expressing frustration with Congress as an institution. Some have special reasons for leaving -- the House bank scandal and a final chance to convert campaign war chests to personal wealth. They share other reasons with legislators: (1) stiff opposition in reapportioned districts, (2) anti-incumbent sentiment, and (3) dissatisfaction with their work, pay, and working conditions. Counts of retiring state legislators aren't yet available, but anecdotal evidence suggests they may also experience unusual turnover. For example, a third of Georgia legislators won't be back, not counting ones who will lose reelection bids.

Wyoming Speaker "Rory" Cross will be one of the legislators not returning by choice. He called this year's session the most contentious in his 18 years of service. No novice at contentiousness, Cross gained local fame last year by describing a tussle with local police (resulting in a misdemeanor guilty plea) as "discussions about law enforcement in Wyoming." The Senate President, with 20 years of service, is also leaving.

If It Feels Good, Do It -- Fiscal Outcomes In Maine

In Maine, where the fiscal situation is even tighter than in Virginia despite large tax increases last year, there were even more reasons for frustration. Several years ago, Republicans and Democrats both achieved parts of their property tax relief agendas with a hybrid plan. Legislators have been backing out of the plan ever since, while making decisions on school and other local aid which greatly increase pressure for local property tax increases. Another major legislative achievement was a universal health plan which has now been whittled down to a paper tiger.

Even frustration-relieving screaming was off limits for Maine legislators this year. Majority Democrats concluded that last year's shouting matches with Republican legislators and a Republican governor, a delayed budget, and stalemate on Workers' Compensation after long acrimonious debate were giving legislators a bad name and possible trouble in the fall elections. So they imposed a gag order on themselves, in the process greatly inhibiting partisan criticisms from Republicans. Workers' Compensation reform, still unresolved, goes to a Blue Ribbon Committee, state reorganization issues remain for consideration next year, and legislators have quietly left Augusta.

PUBLIC OPINION

Governor Wilson is seeking to put an initiative on the November California ballot that combines welfare reform with procedures designed to ensure that the state budget is adopted by the June 15 deadline. Recent California Poll results suggest considerable support for cutting salaries as discipline for budget timing, but reluctance to trust the governor to set the budget unilaterally. The welfare reform comments get a mixed review.

California Voter Opinions On Budget And Welfare Reform

Policy	Favor	Oppose	No Opinion
If the budget is not passed by June 15 each year, should the governor and state legislators forfeit their salaries and per diem payments until the state budget is passed?	83%	13%	4%
Should the governor be permitted to declare a fiscal emergency if the legislature does not pass a state budget by July 1?	30	66	4
Reducing welfare payment to low income families with dependent children from an average of $663 per month to $597 per month for a family of three.	34	61	5
Reducing welfare payments to low income families with dependent children after they have been on the program for six months to an average of $507 per month.	40	53	7
Increase welfare payments by $50 a month to teenage mothers who stay in school to complete their high school education and cut payments $50 a month if they stop attending school regularly.	87	10	3
When low income families with dependent children move to California from another state, limit their monthly welfare payments in the first year to an amount no higher than what was being paid by the state which they left.	76	20	4
Do not increase the amount of welfare payments to low income families when they have additional children.	58	37	5

Another question was: "If Gov. Wilson and the legislature are at odds as to how to reduce the budget deficit, and you didn't know anything about the specifics of the matter, whose position would you be more inclined to support?" The legislature won this trust contest by 54% to 32% (rest undecided) in the January 1992 poll, up from its 47-38 margin when the same question was asked a year earlier.

Voters think their legislature is doing better than the Congress, but don't think much of either. The ratings increase when the responses are confined to those who say they know who their own representative is. That knowledge is claimed by 35% of Californians for their Member of Congress, 28% for State Senators, and 21% for Assembly Members.

Californians View Their Legislators: Job Performance Ratings, Early 1992

Legislator	Excellent/ Good	Fair	Poor/ Very Poor	No Opinion
All Responders				
Member Of Congress	13%	38%	48%	1%
State Legislator	18%	44%	35%	3%
Responders Knowing Representative				
Member Of Congress	46%	31%	23%	--
State Senator	43%	36%	14%	7%
Assembly Member	52%	29%	14%	5%

Voters said they would be more inclined to vote for challengers (40%) than incumbents (33%) for legislative office if they knew nothing else about the candidates. When they were asked whether they would be inclined to elect the incumbent or a challenger in their own districts, however, they preferred their Congressional incumbent 41-29% and their State Senate incumbent 42-27%.

Voters find the level of taxes too high in relation to the services they get. In a December poll in Maryland, 63% of voters agreed with the statement, "In general, the value of the services I receive from government is less than the taxes I pay." A third disagreed (rest undecided). Only 38% agreed with the version of the question that specifically covered state government: "All things considered, state taxes are really not too high considering the services the government provides." Fifty-seven percent disagreed.

MISCELLANY

Controlling Corrections Costs, Another Setback

Many attempts to control corrections costs and comply with court orders on overcrowding depend upon actions that let prisoners out earlier than their sentences specify -- good time, early release, work release, furloughs, and other plans. The risk is that some prisoners will commit new crimes while in these release programs, as some inevitably will. When this happens, state officials, remembering the Willie Horton ads about the Massachusetts release program featured in the 1988 Presidential campaign, often curtail their programs. The latest example is Arkansas. No murder -- just hijacking a small plane, stopping for a robbery, stopping again to refuel, and then disappearing. Governor Clinton has ordered a temporary halt to the furlough program. There are comparable examples in other states.

Economic Recovery Planning

It's time for those interested in state policies to start talking about their strategies for the time when state coffers are flush with revenues from the unexpected strength of the coming economic recovery. Is this bad advice? Probably not. Is it untimely advice? It may be.

Reports shares with organizations of state officials like NCSL and NASBO a perfect track record of warning of the recession before its onset and predicting accurately the consequences for state taxes and spending. But we didn't try to predict the timing. This prevented error, but also meant the warnings substantially predated the onset of recession. The same situation now obtains for recovery.

Economic history suggests there will be a recovery, with higher-than-normal growth for a time. The history of economic forecasting suggests that forecasters will miss the upturn, just as they missed the downturn, and that they will underestimate the strength of the recovery. Given this background and the long leadtimes associated with proposals using state resources, savvy players are probably dusting off old ones and thinking of new ones. Examples: tax cuts, a new round of school equalization proposals, higher education quality programs, new attempts to get welfare recipients jobs, and new ways to deal with health care for the poor.

Legislative Banks

The U.S. House of Representatives bank affair raises the question of whether similar state practices exist. **Reports**' educated guess would have been that there are no comparable banks run by or for legislatures. However, Massachusetts may have been an exception. In a back-page story, the Boston Globe (4/1) describes what it considers to be a parallel case. The bank was recently closed. The state treasurer says its records can't be found.

In the early days, state treasurers were custodians of cash and securities. This is why many state capitol buildings have vaults. States didn't issue checks (instructions to a bank). Instead, they issued, and some still issue, warrants (promises that the issuer will make payment on presentation). Banks honored these, though not required to do so. To provide a facility for the redeeming of warrants, state treasurers had cashiers. The cashier function may still be maintained in some state capitols and can be seen in the architecture of some of them, as well as in the U.S. Treasury building. Some of these might have evolved into banking function beyond honoring state paychecks with cash.

In many organizations, there are employee credit unions subject to regulation by state and federal governments. Like private employers, states may provide office space for these organizations but without direct financial involvement.

TECHNICAL NOTES

Economic Development: The Michigan survey by Public Sector Consultants, Inc. (300 S. Washington Sq., Lansing, MI) appears in its Public Opinion Monitor (Dec. 1991). Other polls came from The American Enterprise (Jan./Feb.). Fosler's quotation is from "State Economic Policy," Economic Development Quarterly (Feb. 1992). The Arizona report, Arizona's Economy Is Everyone's Business, was a supplement in the Arizona Republic (3/15).

Iowa's ad appeared in Business Week (3/23). The others are from Site Selection And Industrial Development (Dec. 1991 and Feb. 1992). The academic studies are Charles Hulten and Robert Schwab, "Public Capital Formation ...," National Tax Journal (Dec. 1991) and Richard Cupitt and Margaret Reid, "State Government International Business Promotion ...," State And Local Government Review (Fall 1991). The new plant announcements are tracked by Conway Data, Inc. (40 Technology Park, Norcross, GA 30092) and printed in its publication Site Selection And Industrial Development (Feb.).

Revenue Enhancement: The chart on fees was derived from The Fees That Ate New York: How Hidden Taxes Are Hurting Our Economy. This 51-page study was issued in January by The Public Policy Institute, an affiliate of the Business Council of New York (152 Washington Ave., Albany, NY 12210).

Revenues from other funds can buoy a state's cash position if unspent. This has happened in Massachusetts and the federal government with revenue from gas taxes. The next step in calling tax increases spending cuts could come from revival of *tax expenditures*. The concept is that putting subsidies in the tax code as credits and deductions has the same impact as paying out equivalent amounts. So is cutting tax expenditures (thereby raising taxes) equivalent to cutting spending? Hints of this approach are appearing in California.

Public Opinion: The California Poll results appeared in the Sacramento Bee (February 4, 7, and 14). The Maryland results were reported in The American Enterprise (March/April 1992). For simplicity in presentation of evaluations of incumbents, the values shown are midpoints of ranges. For more polling results, see Issue 7.

Watch Out For Recovery, For a historical review of recessions and the ensuing recovery, see an article by Stephen McNees in New England Economic Review (Federal Reserve Bank of Boston, Jan./Feb.) plus the extensive citations in that article.

Errors And Omissions: Issue 7 suggested that this year Florida Governor Chiles (D) might parallel Connecticut Governor Weicker (I) last year by vetoing budgets until getting one he likes. This is enough to call Chiles *independent*, but not *(I)*. The graphic on p. 8 of that issue is based on national income accounts data that appear in Survey Of Current Business.

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STATE POLICY REPORTS

VOLUME 10 ISSUE 9

IN THIS ISSUE

State finances are in worse shape ~~than~~ suggested by the governors' budgets and legislative actions. Particularly in the large states, budgets have been overtaken by bad news on both revenues and spending.

- State Finances, Worse Than They Seem p. 2
- How Bad Are State Fiscal Conditions? p. 4

Many states have been reducing deficits in the current year by increasing spending and reducing revenue in the next. California and Rhode Island are now trying to deal with the results. Most of Michigan's large shortfall will be shifted to future years rather than handled by spending cuts or tax increases.

- Cascading Fiscal Problems p. 9

Blaming state fiscal problems on the federal government is popular, but increases in federal grants have killed the argument that federal aid is declining. State and local officials are cutting their recession-induced deficits. Federal officials aren't.

- Declining Federal Aid? p. 13
- Federal And State Deficits p. 14

States are finding many ways to use federal Medicaid grants to provide budget relief.

- The Medicaid Bailout? p. 16

The problem is delivering tax cuts and new initiatives with no money for them. The solution is sometimes to promise future delivery.

- Promises, Promises p. 20

Information on state finances is often conflicting, and clearly insufficient to support newly published rankings of state fiscal stability. Technical notes detail sources and other caveats.

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May 1992 (First Of Two May Issues)

STATE FINANCES, WORSE THAN THEY SEEM

> *The state's budget is being shored up by a series of one-time revenue "enhancements," including the use of the entire rainy day fund and transfers to the general fund from other state funds. Nothing has been done, or is currently underway, to put the FY 1998 budget back into balance. Unless the legislature comes up with a permanent tax increase, draconian budget reductions appear to be the only remaining alternative....*
>
> *{This observer} is betting on a permanent tax increase enacted by a lame duck legislature. ... If Republicans gain control of the House, Democrats who control it might very well choose to wait and let the new Republican leadership deal with the problem in January.*

This comment from a former legislative fiscal officer in Ohio reflects the increasingly serious fiscal problems being recognized in the larger states. It also reflects insider assessments that legislators are finessing problems until after the 1992 elections. It raises the possibility of **major tax increases in lame duck legislative sessions** late this year. Resolving recession-induced election-year fiscal problems by post-election tax increases was popular in the early 1980s. In 1982, five states followed this path. Most states increased taxes then or early in their 1983 sessions.

Fiscal Problems Crowding Out Other Issues

Fiscal problems are now causing a moratorium on new money-using state initiatives. In many states, the debate is concentrating on how much to trim and how to postpone previously adopted initiatives. Where decisionmakers insist on major new initiatives, they are being enacted with delayed implementation, presuming future fiscal conditions will be better.

Many legislative sessions are evolving like this issue of **Reports**. The original plan included dealing comprehensively with such issues as education reform, employee compensation, and broadening health insurance coverage. The outcome is mostly a discussion of fiscal problems and choices. The issues in education, health, and other fields shifted from major policymaking to arbitrary choices such as deferrals, freezes, and borrowing to avoid deeper spending cuts.

While some might expect fiscal problems to produce an outpouring of actions to reduce spending, not much of this is happening either. Many cost-cutting choices entail heavy front end costs and/or unpopular election-year decisions that, like resolution of fiscal problems, are often being deferred until after November.

How The Problems Developed

The fiscal problems are unfolding just about as predicted by experts, such as in the January "Red Ink Issue" of State Budget & Tax News. The results from FY 1991 were worse than expected in the calculations underlying the FY 1992 budgets. This carried lower-than-expected balances into FY 1992. Many of the FY 1992 budgets were based on an economic recovery that didn't materialize and on spending projections that are proving optimistic. These problems from FY 1992 and a sluggish economy sour the FY 1993 outlook, particularly in states that avoided tough decisions to curtail spending or raise taxes.

There isn't new bad news about state economies. But the old bad news is just working its way into revised estimates. In many cases -- such as California, Illinois, and Ohio -- this means the premises on which governors based their January budgets are now incorrect. Revenue estimates in both the budgets and the new financial plans assume resumed prosperity, but the revisions will reflect a lower base for the FY 1993 growth.

California is an example, though its numbers are larger and its problems worse than most states'. Last summer, California leaders adopted spending restraint and tax increases to close a budget gap of $14 billion. When the governor submitted his budget in January, there was a new gap of $5 billion or so, which his proposals were designed to close. In April, the governor announced the shortfall was likely to be $9 billion. This is terrible news for legislators and the governor, whose popularity in public opinion polls is already at record lows. Many of the~~m are trying~~ to avoid: (1) tax increases, (2) violating the constitutional mandate for education funding, and (3) bitter, and vote-losing, partisan disputes. They may be forced into all three.

The good times have stopped rolling nearly everywhere as fiscal problems reach the states that previously avoided them. The growth rate in the best-performing state economies has slowed -- bringing problems to states like Hawaii, Nevada, and Washington. Oil prices and declines in oil and gas drilling have created major problems for Alaska and Wyoming and pressured budgets in states like Kansas, North Dakota, Oklahoma, and Texas. States with strong reserves have been depleting them.

The responses have been uneven. In the Southeast, strong laws and traditions favoring mid-year corrections to keep balanced budgets led to proration of spending in Alabama, Arkansas, and other states. Governors clamped down administratively to cut major items like school aid in Florida, Georgia, and Mississippi. Legislatures acted in special session in Georgia and Florida. But in the Northeast and California, little happened. In a few situations, like Illinois, leaders held a posture of rejecting the message of the fiscal doomsayers. In others, particularly California and New York, governors urgently called for legislative action, but didn't get their wishes.

HOW BAD ARE STATE FISCAL CONDITIONS?

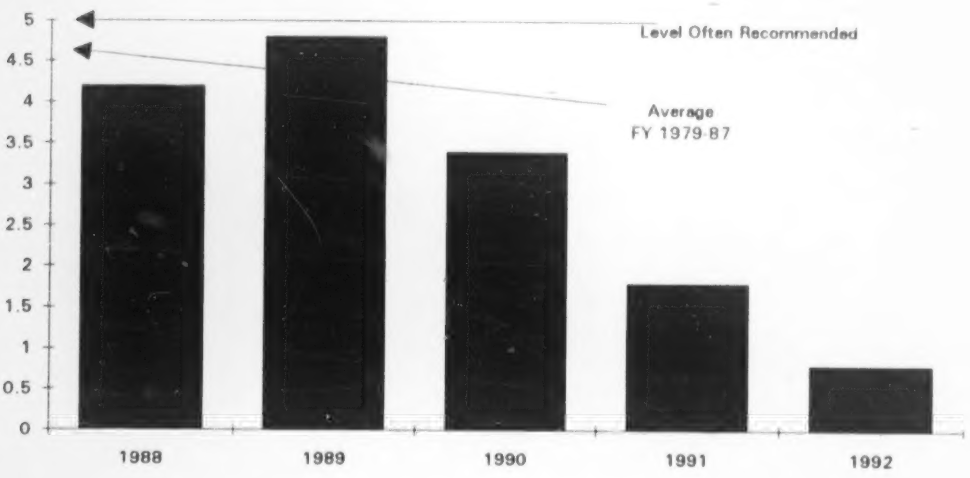
> *The fiscal condition of states continues to be very weak. ... Clearly, the downturn over the past two fiscal years, 1991 and 1992, has left major scars on state finances.*

These discouraging words begin the Fiscal Survey Of The States released in late April by the governors (NGA) and state budget officers (NASBO).

Balances Are In Terrible Shape

The states have rapidly depleted their balances. The chart shows the steady decline from FY 1989 to 0.8% of spending predicted for the combination of rainy day funds and regular balances at the end of FY 1992 (this June in 46 states). That level is well below the 5% target recommended by some fiscal experts. Achieving that target would require balances of $15.4 billion at the end of FY 1992. Instead, balances are expected to be only $3.3 billion ($325 million in regular balances and $2.2 billion in rainy day funds).

State Balances At End Fiscal Year
As Percentage Of Year's Spending



These projected balances are below the average from FY 1979 and FY 1987. The balances are also below the 1.5% hit at the end of FY 1983, the last time state finances were devastated by recession. NASBO members don't expect much improvement, with the projections for FY 1993 reaching only 1% on the expectation of resumed economic growth.

Projected balances can easily be eroded. In October, NASBO's survey showed the enacted FY 1992 budgets had estimated year-end regular balances of $4.1 billion. From then to April, the number dropped nearly $4 billion despite many budget cutting actions. The causes -- higher-than-expected spending and lower-than-expected revenues -- are continuing to take their toll.

Individual State Balances Vary Widely

The national totals conceal the large variations illustrated by the table.

Total Balances Ending FY 1992, Selected States ($ millions)

State	General	Rainy Day	State	General	Rainy Day
Alaska	$177	$639	Nebraska	$141	$27
California	-1,344	0	New Jersey	403	0
Hawaii	382	0	Oklahoma	216	186
Indiana	52	325	Oregon	290	0
Michigan	-785	194	Texas	-428	164
Minnesota	256	0	Washington	-98	260

The table below relates balances to spending. Corrective actions will eliminate or at least shrink the negative numbers, but often just by shifting the problems to FY 1993.

Total Balances As A Percent Of Expenditures, End FY 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Alaska	28.1%	18	Colorado	2.7%	34	Virginia	0.4%
2	North Dakota	15.3	19	Idaho	2.6	35	Maryland	0.2
3	Hawaii	13.8	20	Mississippi	2.2	36	Arizona	0.1
4	Oklahoma	12.6	21	Washington	2.1	37	Alabama	0.0
5	Nebraska	10.9	22	South Carolina	1.8	38	Arkansas	0.0
6	Oregon	10.8	23	Wisconsin	1.8	39	Connecticut	0.0
7	Wyoming	9.6	24	North Carolina	1.3	40	Georgia	0.0
8	Delaware	8.7	25	West Virginia	1.2	41	Louisiana	0.0
9	Indiana	6.5	26	Kentucky	1.1	42	Maine	0.0
10	Kansas	5.0	27	Missouri	1.1	43	New York	0.0
11	Utah	4.5	28	Illinois	0.9	44	Pennsylvania	0.0
12	Nevada	4.3	29	Massachusetts	0.9	45	Ohio	-0.1
13	Minnesota	3.9		**United States**	**0.8**	46	New Hampshire	-0.6
14	New Mexico	3.5	30	Florida	0.6	47	Texas	-1.5
15	South Dakota	3.5	31	Iowa	0.5	48	California	-3.1
16	Montana	3.1	32	Rhode Island	0.5	49	Michigan	-7.5
17	New Jersey	2.8	33	Tennessee	0.4	50	Vermont	-7.7

Few states show normal late 1980s patterns: balances in rainy day funds (in the states that use them) and significant reserves. Instead, the table shows healthy fiscal situations at the end of FY 1992 in just a few states (e.g., Indiana, Minnesota, and Nebraska). There are many extraordinary situations including some unusually large balances (e.g., Alaska, North Dakota, and Hawaii) and some negative balances (e.g., California, Michigan, and Vermont). There are only seven states in the 3-5% range. In most years, many more states have been in this range.

Spending Exceeds Revenue In Most States

State budgets are defined as balanced if *resources* available to finance them exceed spending. On this basis, NASBO's survey shows state budgets are balanced in FY 1992 in the aggregate. But if balance means financing current spending with *current revenue*, the budgets aren't balanced because nearly $4 billion of spending is being financed by drawing down balances. This test of whether budgets are balanced was used to construct the table below. It shows bad news for most states. Nationwide, states expect to spend 1.2% more than revenues, with only 19 states covering current spending with current revenue.

Excess Of Revenues Over Spending As Percent Of Spending, FY 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Pennsylvania	3.3%	18	South Carolina	0.0%	34	South Dakota	-1.9%
2	New Hampshire	3.0	19	New Mexico	0.0	35	Rhode Island	-2.0
3	New Jersey	2.8	20	Iowa	-0.1	36	Nevada	-2.1
4	Vermont	2.3	21	Missouri	-0.1	37	Nebraska	-2.2
5	Colorado	2.2	22	Mississippi	-0.2	38	Kentucky	-3.1
6	North Carolina	1.3	23	California	-0.2	39	West Virginia	-3.3
7	Hawaii	1.3	24	Maine	-0.2	40	Oregon	-3.3
8	Oklahoma	1.2	25	Delaware	-0.5	41	Idaho	-3.4
9	Virginia	0.4	26	Utah	-0.5	42	Minnesota	-4.6
10	Maryland	0.2	27	Georgia	-0.9	43	North Dakota	-6.5
11	Tennessee	0.2	28	Massachusetts	-0.9	44	Texas	-6.6
12	Illinois	0.1	29	Indiana	-1.0	45	Washington	-7.4
13	Wisconsin	0.1	30	Ohio	-1.1	46	Michigan	-7.9
14	Alabama	0.0	31	Arizona	-1.1	47	Montana	-8.3
15	Arkansas	0.0		**United States**	**-1.2**	48	Louisiana	-9.4
16	Connecticut	0.0	32	Florida	-1.3	49	Wyoming	-11.2
17	New York	0.0	33	Kansas	-1.5	50	Alaska	-21.5

The top states are experiencing boosts in revenue from tax increases (New Jersey and Pennsylvania) or windfalls from Medicaid payments (New Hampshire). Many of the negative numbers are associated with slumping oil and gas revenues as well as deliberate draw downs of balances built up for exactly the contingencies being experienced this year. Examples are Indiana, Kansas, Minnesota, Oregon, and Washington.

Revenues Generally Below Estimates

A major portion of the problems being encountered this year is attributable to revenues not performing as well as expected when budgets were enacted. Only a few smaller states reported revenues above expectations. Nationwide, sales taxes revenues are falling about $2.5 billion short, personal income tax revenues are off about $3.3 billion, and corporate income taxes show a shortfall of $1.4 billion. The range of error is from an underestimate of nearly 15% to an overestimate of nearly 7%.

Change From Estimate
Sales Tax, FY 1992

Rank	State	Percent
1	Massachusetts	14.6%
2	Minnesota	0.6
3	Missouri	0.2
4	North Carolina	0.0
5	Texas	0.0
6	Louisiana	-0.1
7	Wisconsin	-0.3
	Unlisted States	**-0.5**
8	Tennessee	-1.1
9	New York	-1.5
10	Pennsylvania	-1.6
11	Kentucky	-1.9
12	New Jersey	-2.0
	United States	**-2.4**
13	Indiana	-2.5
14	Arizona	-2.5
15	Ohio	-2.7
	Listed States	**-2.7**
16	Arkansas	-2.8
17	Connecticut	-3.0
18	Washington	-3.0
19	Michigan	-3.6
20	South Carolina	-4.2
21	Illinois	-4.2
22	California	-4.9
23	Maryland	-4.9
24	Florida	-5.8
25	Georgia	-6.0
26	Virginia	-6.7

The table shows the difference between the original estimate of sales tax revenues, in the states with $1 billion or more such revenues, and the estimate current when the states responded to the NASBO survey this spring.

The **Massachusetts** results are an error in state estimates, not in reporting. Before the FY 1992 budget was enacted, many observers said the estimates were way out of line, as they now appear to be -- bearing little resemblance to the direction of error (overestimates, not underestimates) and the magnitude of error (0-4%) in other Northeastern states.

The largest percentage errors appeared in the Southeast, particularly in **Florida**, **Georgia**, and **Virginia**. The **California** error of 4.9% is indicative of shortfalls experienced in all of the state's major revenues. The shortfalls were generally smallest in the less populated Western states, those shown as "unlisted" on the table.

NASBO calculates that overall state tax collections are running about 3% below the original estimates used in the 1992 budgets. As a result,

> *Unless other revenues offset these decreases, states are forced to reduce their enacted budgets or use reserve funds to balance FY 1992 budgets.*

These shortfalls are associated with over $5.7 billion of cuts NASBO counts as having been made after the FY 1992 budgets were passed. But the cuts were insufficient to offset the poor revenues, so the drawdown of balances has been automatic in many states.

Spending Exceeding Projections

> *We're continuing to hear bad news from the states because they are not only seeing slower growth in revenues but they are also continuing to see an explosion in cost for health care, corrections, and social programs like welfare.*

The scissors cutting state finances to shreds have two blades. One is recession-depressed revenues. The second is spending growth, summarized in the quote from NGA's executive director as he described the latest fiscal survey. In the aggregate, the factors increasing spending over estimates have overwhelmed decisions to reduce spending. The results appear in the evolution of spending estimates in the Fiscal Survey.

Total General Fund Expenditures ($ billion), Successive NASBO Surveys

Survey Issue Date	FY1991	FY 1992	FY 1993
April 1991	$288.0	$296.6	n/a
October 1991	287.2	301.5	n/a
April 1992	292.5	307.0	318.0

While there are some signs of relief from persistent underestimates of corrections costs, Medicaid costs may again outrun the amounts budgeted for FY 1992. The desire to adopt apparently balanced budgets while avoiding tax increases gives strong incentives to underestimate Medicaid spending in the FY 1993 budgets as well.

The Outlook Is Poor

State revenues have been performing poorly so far in FY 1992. The latest report from the Center for the Study of the States shows tax collections in the October-December quarter up 6.3% from the previous year. However, 5% was associated with tax increases while only 1.3% was associated with inflation and changes in economic activity. Personal income tax growth was strongest at 8.9%, but only 3.9% was associated with economic changes and the rest with rate hikes. Sales taxes, without rate changes, would have increased 0.9%. With them, the increase in revenue was 5.9%.

Slow revenue growth is seen for FY 1993. The NASBO survey projects that FY 1993 state general fund revenues will be $318.8 billion, up $16.6 billion from revenues expected in FY 1992. However, this increase includes about $5.1 billion from tax increases recommended by the governors. Without them, the revenue increase would be about 4% -- barely enough to beat projected inflation.

The revenue situation as elected officials see it unfold is much less pleasant than projected increases alone suggest. **Much of the projected revenue increase is needed to offset shortfalls.**

The sales tax estimates provide an illustration. In the new budgets nationwide, elected officials are being told that sales tax revenues (without new tax increases) will rise from $101.3 billion in FY 1992 to $106.1 billion in FY 1993. This projected increase of about 5% reflects the economic recovery generally being predicted for FY 1993 and is well above the predicted inflation rate. However, the FY 1992 sales tax revenue estimate that legislators used in developing the FY 1992 budgets wasn't the current FY 1992 estimate, but a higher $103.8 billion. So the increase in FY 1993 over *what legislators thought they had for FY 1992* is only 2%.

Put another way, without tax rate adjustments, legislators would have to apply sales tax revenue growth of $4.9 billion: (1) $2.5 billion to plugging the shortfall in FY 1992 revenue and (2) $2.4 billion to finance FY 1993 spending growth. This example, with half of this year's revenue growth needed to plug last year's shortfalls, is typical of many situations throughout the country. Uncured budget problems from one year automatically slide into the next.

CASCADING FISCAL PROBLEMS

FY 1993-

The chickens come home

to roost

The **Rhode Island** budget office used this graphic late last year to brief legislators on the problems likely to result from past actions to defer fiscal problems, actions that covered nearly 10% of the budget. In Issue 2, **Reports** used it and an assessment by the legislative staff in **California** to show how fiscal problems in the new budgets would develop out of the easy solutions of the present one.

FY 1993 Problems In Two States

These situations, and others like them, are playing out as badly as expected. In **California**, the problems are so severe that both the governor (R) and legislative leaders (D) have avoided proposing comprehensive solutions out of fear that unless they act jointly (which they show few current signs of doing), the first to act may well be shot as the messenger bringing the bad news.

In **Rhode Island**, the governor has a solution that would appear to balance the budget but at a price: (1) all "temporary" tax levels remain in effect, (2) sales taxes are increased by broadening the base, (3) various revenues are accelerated, (4) the medically needy portion of Medicaid is eliminated, (4) school aid is basically frozen, (5) local aid is cut to about a fourth of the level in FY 1988, (5) other funds are tapped to bail out the general fund, (6) general assistance payments drop and eligibility is reduced, and (7) similar changes in other programs and revenue sources.

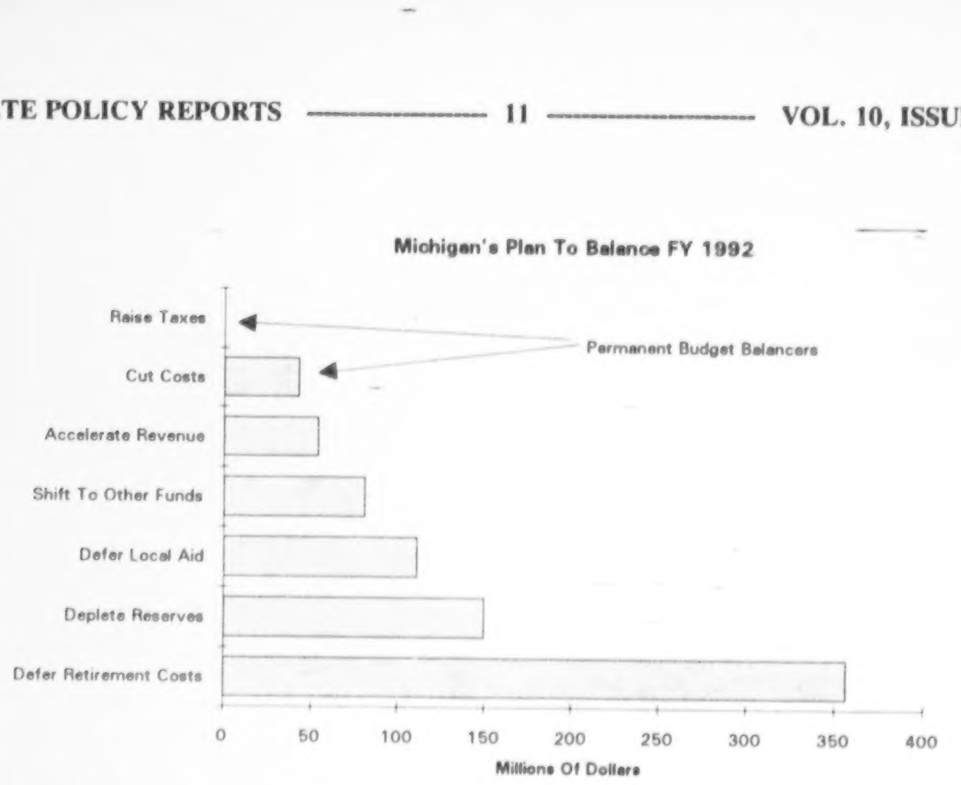
Dealing With FY 1992 In Michigan

The Painless Plan: The situation in FY 1993 is most severe in those states that still haven't solved their FY 1992 problems. Michigan (with a fiscal year beginning in October) is a classic case of both what can be done to avoid tax increases and the hazards for future year state finances. The FY 1992 budget now has an admitted shortfall of about $800 million, nearly 10% of the general fund. In mid-April, the governor issued his plan to close the gap. He told legislative fiscal panels that the plan "balances the budget and protects education" with no new taxes. Furthermore, "essential services are maintained, with no cuts in social services or public protection programs." The budget director assured legislators that most Michigan residents would be unaffected by the spending cuts.

Prefunding Retiree Health Costs: Among other things, the governor proposed a change in the method of funding health care costs for retirees designed to "save" $188 million. Most states pay these costs as they go along. However, they clearly are akin to retirement cash payments, so under generally accepted principles now being applied to the private sector, their costs should be recognized during employees' working years. Only a few states besides Michigan (Kentucky, New Jersey, New Mexico, and North Dakota) do this. Moving Michigan to pay-as-you-go financing would avoid the other choices he offered: (1) cutting school aid by 20%, (2) raising the personal income tax by 11%, or (3) cutting welfare benefits "to levels in Arkansas," plus cutting school aid by 8%.

Deferring 95% Of The Problem: This plan was only one of the ways the proposal avoids major spending cuts and tax increases. By repackaging it, **Reports** produced the chart on p. 11. It reflects only $43 million of spending cuts and no tax increases in gap-closing measures of $796 million. The $43 million includes reductions in building maintenance, postponing equipment purchases, and other items that might be considered spending deferrals. The chairman of the Senate Appropriations Committee said he had a "conscience problem" with some of the one-time measures. The budget director agreed that they are "not ideal," but argued they were better than the alternatives.

The spending cuts were dwarfed by supplemental appropriations that added to FY 1992 spending and increased the budget gap. They included over $100 million for schools to cover a Michigan pattern of underestimating school foundation payments, $24 million in other education programs, and $15 million for other agencies.



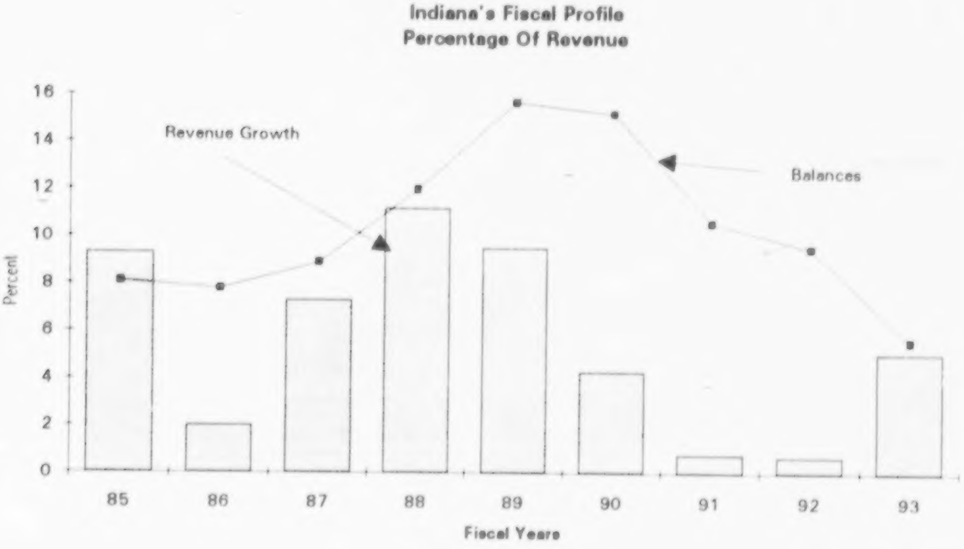
Legislative action is more likely to increase, rather than reduce, the extent to which shifting problems to future years is used to resolve the FY 1992 budget gap. There is opposition to some of the spending reductions which the Lansing State Journal (4/17) described as "modest." There is interest in the legislature in committing the entire rainy day fund to filling the gap, rather than just using most of it as the governor proposed.

Carrying Problems Into FY 1994

Even when state finances appear comparatively good, they can be considered bad. **Indiana** has managed its finances as experts recommended to state officials seeking to avoid sharp tax hikes or spending cuts when unfavorable contingencies, such as recession, occur. As a result, it hasn't made major changes in taxes and has handled spending by limiting increases, not making cuts. This conclusion has appeared previously in SB&TN and has resulted in Governor Bayh (D) getting high marks from the conservative CATO Institute in a recent ranking of governors' fiscal policies (see Issue 6).

The governor likes to brag about these assessments, to the consternation of some Hoosiers. One of Bayh's critics, Senator Mills (R), chairs a key fiscal subcommittee. He has protested vociferously at 12-page length to the Wall Street Journal (for publishing the CATO rankings) and to SB&TN. His concerns are not consistent: (1) "Clearly, Indiana is on a crash course to hit the fiscal fan." and (2) Governor Bayh is getting credit belonging to prior governors (R) and legislators (R).

By accident or design, Indiana's fiscal strategy has closely conformed to the recommendations of many reports written in the aftermath of state fiscal problems in 1982 and 1983. They recommended building reserves in good times, particularly when revenue exceeds estimates, and protecting some of the resulting balances as budget stabilization or rainy day funds. Indiana did this as shown on the chart.



Balances were built in the prosperous late 1980s. When revenue growth dropped below 6%, the Indiana average, balances were drawn down. The balances didn't have to replace all of the revenue shortfall because spending growth was held below 6%. To constrain spending, Indiana resorted to measures recently used by many states. Debt financing was used for many capital outlays. Lottery proceeds were shifted from earmarked uses to support of the general fund. Payments to local governments were deferred.

The net effect of all these measures has been to permit enactment of balanced budgets without new taxes and without painful spending cuts. As calculated by the Indiana Fiscal Policy Institute, the result is the pattern shown in the table.

As it moves to FY 1994 issues in next year's legislative session, Indiana has a problem even if its assumptions all work out. To continue in FY 1994 all of the expenditures financed by one-time items in FY 1993 would require all of its 6% normal revenue growth. If it retains its diversions and delays, it would still have to devote over half of normal 6% revenue growth to funding what was funded with reserves in FY 1993.

Indiana's Budget-Balancing Measures, FY 1991-FY 1993 ($ million)

Category	FY 1991	FY 1992	FY1993
Spending Without Accounting And Timing Changes	$5,812	$6,137	$6,311
Spending Reductions	0	65	55
Use Of Reserves (Net)	276	81	223
Delay In Local Aid Payments	0	293	10
Diversion of Lottery Revenues	0	120	160
Percentages Of Spending			
Real Spending Cuts	0%	1.1%	0.9%
Delay and Diversion	0	6.7	2.7
Reserve Drawdown	4.8	1.3	3.5

Thus, a state that managed its way through recession more or less "by the book" faces future problems. Indiana's situation will be even worse if recession doesn't end on schedule. It wouldn't get the revenue growth anticipated to be 5.1% in FY 1993 and more in FY 1994. Other states that haven't raised taxes have comparable problems. In Wisconsin, the budget for FY 1993 contemplates drawing down balances, one-time revenue, and spending deferred into FY 1994. Minnesota and Virginia are also examples.

DECLINING FEDERAL AID?

State and local officials have been attributing fiscal problems to federal cuts since the rapid growth in federal aid slowed late in the Carter Administration. The concerns were particularly strong in the early 1980s after the Reagan Administration discouraged growth in many programs and cut back or eliminated others. Given this history, the discussion of federal aid in Issue 7 was bound to disturb some state and local officials. It did.

That discussion showed federal grants increasing from 1990 to 1991 by 17.4% while state and local tax revenues were growing about 5%. Since it was published, the Commerce Department has estimated that federal grants in 1992 are likely to increase "nearly 20%." Total state and local receipts in the same period are likely to about match the 6.5% increase in CY 1991, so state and local receipts from their own taxpayers will again increase at a third or less of the increase in federal grants.

The notion of *federal cuts* has never been supportable in terms of current dollar outlays. In 1992, federal grants to state and local government will be about $182 billion, up from $103 billion in 1987, $89 billion in 1980, $55 billion in 1975, and $24 billion in 1970. So the case for *cuts* depends upon a concept of what federal aid *should have been*.

One approach is to pick a base year and presume aid should grow from that base to match inflation and population growth. But state and local governments increased their spending, particularly in the flush late 1980s, considerably faster than necessary to match price and population increases. For example, over the five years ending in 1992, the Consumer Price Index has increased about 24% and population grew about 6%. The increase in federal aid during the same period will be about 77%.

Not everyone agrees that state and local spending should have increased so rapidly. Not everyone agrees that if state and local officials decide on such rapid growth, there is an obligation for the federal government to match it and that failure to do so is a *cut* in federal aid. But presuming that federal aid should share proportionally in financing the increase has been an integral portion of the case for *declining* federal aid for years. By this approach, one reader protested the Issue 7 article, arguing that federal aid has contributed to state and local fiscal problems.

To make this argument, the starting year must be a peak year in federal aid as a percentage of state/local receipts -- the reader picked 1977. The ending year must also be carefully selected -- the reader picked 1988. On this basis, there is a cumulative shortfall of about $200 billion, the difference between actual federal aid and what aid would have been if maintained as a constant percentage of state local receipts. The relevant percentages are 18% in 1970, a peak period of just below 23% in the late 1970s, a low of about 17% in the mid- to late-1980s followed by 18.2% in 1990, 19.8% in 1991, and an estimated 22.1% this year. Even picking the most favorable base year for comparison barely indicates a shortfall now. Sometime in 1992 or early 1993 federal aid will have matched the highest percentage of state and local receipts in history. As pointed out in Issue 7, blame for part of the current state and local fiscal problems can be placed on the federal doorstep, but the reasons don't include federal aid cuts, no matter how far one goes to define *cuts*.

FEDERAL AND STATE DEFICITS

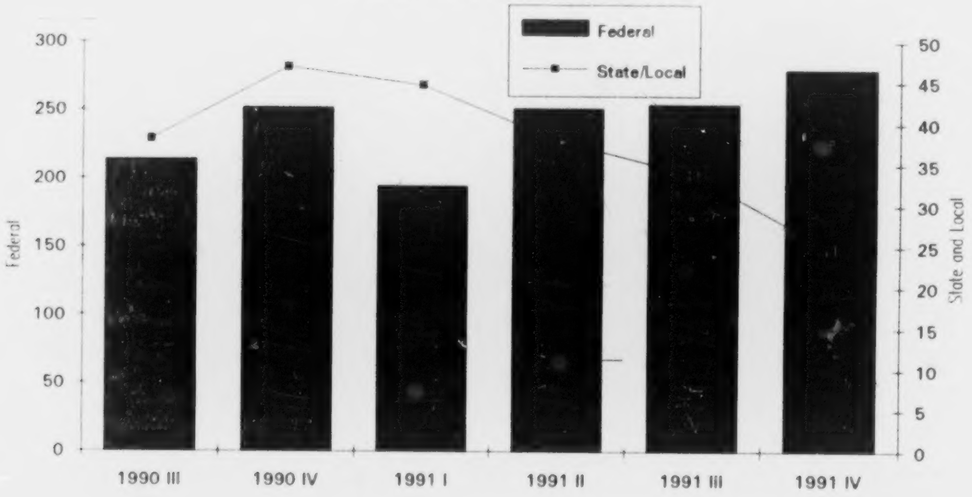
> *The single most important factor affecting the fiscal condition of states is the health of the national and global economies. ... together states have a common interest with the federal government in finding a sustainable path for the federal budget that brings federal expenditures in balance with revenues.*

As these comments in the Fiscal Survey suggest, state officials continue to worry about the impacts of a growing federal deficit on the economy and thus on state budgets. Excluding trust funds, the federal government is borrowing to finance 20% of its spending. State and local governments cover about 3% of their spending by borrowing, mostly bond issues for long-term capital outlays.

Federal borrowing is not differentiated by whether it supports capital or operating costs, but any method of calculation suggests it mostly funds an operating deficit. The federal government pays net interest of nearly $200 billion a year while state and local governments *collect* about $60 billion. Interest they earn exceeds interest they pay.

The battle for federal deficit control is not going well, as suggested by the columns in the chart. These quarterly deficit levels are projected to grow in 1992, but may start to decline somewhat in mid-1993 *if* the assumptions of the President's budget are achieved.

Trends In Government Deficits
($ billion, excluding trust funds)



The chart shows that both levels of government are responding to recession in classic fashion. As recession develops, deficits starts to rise. The federal deficits remain large through inaction permitted by deficit financing and because many decisionmakers seek economic stimulus from an excess of spending over revenues. Balanced budget requirements force quick state and local adjustments, including some overcorrection to restore lost reserves. This results in rapid reduction of their deficits at the expense of policies, such as layoffs and tax increases, that contribute to recession.

The adjustments were probably most rapid in local governments. They are appearing in the state data as well as states run out of rainy day funds and other balances with which to finance spending in excess of revenues and the few states that borrow for operating costs seek to repay that debt, or at least prevent its increase. The NASBO survey shows deficits in state general funds of $6.2 billion in FY 1991, $3.8 billion in FY 1992, and a projected $0.9 in FY 1993.

THE MEDICAID BAILOUT?

Medicaid costs have been a massive burden for state finances, one magnified by mandates of coverage, litigation on reimbursement rates, and federal laws and regulations that cut off nearly every avenue of state escape from double-digit cost increases. The effects have included state taxes higher than they would otherwise be and less funding for state priorities, particularly education, than would otherwise have been the case. Proofs of these statements are constantly unfolding in every state and in **Reports**.

This said, **Medicaid is bailing many states out of fiscal problems.** In theory, state costs and federal aid have been growing in lockstep at double-digit rates to reflect: (1) more recipients because of demographic changes and economic problems, (2) recipient growth caused by mandated increases in coverage of pregnant women and young children, (3) general inflation, (4) health care inflation exceeding general price increases, and (5) expanded services reflecting new technology, defensive medicine, and other factors. In practice, state general funds aren't absorbing all these pressures. Some are getting bonuses from Medicaid financing that free resources for other uses. The phenomenon isn't easily quantified, but anecdotal evidence is becoming overwhelming.

There is big money in disproportionate share payments and retroactive claims. This money was big enough so that the "windfall" was credited with saving Massachusetts from deficit. In New Hampshire, knowledge that the money was coming turned a debate over whether to enact a personal income tax or substantially increase taxes on business into a decision that neither was necessary. In Rhode Island, the extra money ($265 million) is known locally as a *windfall* and a *fiscal miracle*. Half is being spent for Medicaid, but half is the equivalent of unrestricted revenues, like revenue sharing. It is being used to unwind borrowing from a state authority, replenish the rainy day fund, and move some school aid payments deferred into FY 1993 back into FY 1992. If the per capita windfall in all states were the same as Rhode Island's, the national fiscal relief would be $33 billion.

There is big money in aggressively establishing Medicaid eligibility for clients and facilities now funded with 100% state and local money. There are many institutional reasons why some services are 100% paid with in-state resources when they are eligible for Medicaid coverage. It has long been argued that public hospitals are insufficiently motivated to seek reimbursement because public subsidies cover their losses. This has been one of the arguments behind the shift of Mississippi's state hospitals and many county and city hospitals to the private and quasi-private sector.

These arguments apply to state mental institutions, residential facilities for the retarded, and veterans' homes. Many of these facilities would have to be upgraded in physical plant and staffing to qualify for Medicaid. Tight budgets and the possibility of shifts to community programs have discouraged these investments despite the substantial Medicaid payoff.

An alternative to upgrading state facilities is to increase efforts to shift patients from institutional settings to purchased community and residential care. Medicaid reimbursement motivated such moves in Massachusetts, among other states. Many patient advocates and mental health professionals have long sought such changes on therapeutic grounds alone.

Other shifts are small, subtle, and impossible to quantify. For example, St. Louis leaders are debating shifting certain maternal and child health functions from the city's health agency to the city-county hospital. One argument for the change is increased Medicaid reimbursement. Public health agencies, like city and county health departments, are oriented to providing service to all comers free or at nominal cost. They probably aren't aggressive or skilled at establishing clients' Medicaid eligibility or at keeping the books and doing the paperwork for Medicaid. Hospitals have this experience and motivation.

If costs of service remain the same, every dollar's worth of Medicaid service means 50 cents less state and local spending in the most affluent states. More savings are available in states where the federal cost sharing percentage exceeds 50%, as shown on the table.

Projected Federal Share Of Medicaid Costs, FY 1994

State	Percent	State	Percent	State	Percent
Mississippi	78.64%	South Dakota	68.06%	Ohio	60.32%
West Virginia	75.85	Tennessee	67.47	Vermont	60.29
Utah	74.77	Arizona	66.68	Wisconsin	59.97
Arkansas	73.97	Wyoming	65.91	Kansas	58.09
New Mexico	73.57	North Carolina	65.90	Michigan	56.30
Louisiana	72.99	Texas	63.93	Florida	55.40
South Carolina	71.05	Indiana	63.11	Pennsylvania	55.16
Kentucky	71.02	Georgia	62.57	Minnesota	54.72
Alabama	70.93	Maine	62.11	Rhode Island	54.64
Idaho	70.53	Oregon	61.98	Washington	54.20
North Dakota	69.69	Iowa	61.85	Colorado	54.02
Oklahoma	69.40	Nebraska	60.94	Nevada	53.22
Montana	69.28	Missouri	60.51	**All Others**	**50.00**

Bootstrap financing is still working. The compromise federal legislation enacted late last year was designed to halt the burgeoning use of bootstrap financing. The price paid by states was to lose this source of potential future revenue. But to make it feasible of enactment, it immunized state practices in effect in FY 1992 for that fiscal year, longer in some cases. It also closed the d~~oor on fede~~ral attempts to declare any past financings invalid and opened the door wide for states proceed to the limits allowed by the new legislation.

The states are clearly taking advantage of these provisions, though no one has a count of how many or how much financial gain.

Provider taxes are proving popular. The states, particularly ones that used provider "donations" to finance Medicaid state contributions, are adopting financing arrangements permitted by the new federal legislation. The most popular one is a tax on health care providers, particularly hospitals. It is based upon measures of gross activity, whether covered by Medicaid or not, such as gross revenues or bed-days.

There is substantial state ingenuity in these arrangements. The counsel of West Virginia's tax agency recently described that state's new levy as a tax of 23% of Medicaid billings. Viewed this way, an added $100 in Medicaid spending results in: a $77.68 federal payment under the FY 1992 cost sharing percentage and a state outlay of the remaining $22.32. The added state tax revenue of $23.00 is enough to cover the entire state share of the added payment with money left over for administrative costs. This would make added costs from higher reimbursement rates free to West Virginia taxpayers and health care providers, which may explain why the state raised those rates. It would also tend to induce an escalation in Medicaid costs, as no one in West Virginia would have any reason to control them. The reported increase from FY 1992 to FY 1993 is 53%.

A somewhat less extreme case is developing in Tennessee, one of the states being forced to eliminate its donation program. The plan recently approved by the Tennessee Hospital Association would fund all Medicaid spending with 70% of the money coming from the federal government, about 13% from the state, and about 17% from the providers. Hospitals have agreed to pay $358 million with another $36 million to come from nursing homes. A gap of $60 million is yet to be filled. The Tennessee Medical Association alerted its members to the possibility of a fight against raising $21 million from doctors with a tax that would average $4,000 per year each.

In cases like Tennessee's, the state may be paying 13% of all Medicaid costs, but not necessarily 13% of any increases. One possibility is to increase reimbursement rates for doctors with 100% of the increase paid for by the doctors. The higher rates might increase the number of participating providers, as it did in West Virginia where 750 more doctors and dentists signed up to take Medicaid patients after rates were raised. The added costs would come 70% from the federal government and 30% from doctors' pockets. No one can predict (or audit after the fact) how the money will get into doctors' pockets. Lower compensation to doctors is a possibility, but higher Medicaid charges are a better bet. Non-Medicaid patients will lose to the extent that the provider taxes are passed along to them. They will gain to the extent they are relieved of cross subsidies for low Medicaid reimbursement rates and non-paying patients.

Windfalls are appearing in federal numbers. The March Survey Of Current Business reports calendar year federal Medicaid spending up 21.5% in 1990, 32.4% in 1991, and estimates an increase of 33% in 1992. These numbers suggest windfalls, as they are well above the Medicaid increases in state budgets. With constant cost sharing ratios, the increase in federal spending must be matched by an equal increase in state spending.

The 32% and 33% increases aren't reasonably related to underlying costs. Private health insurance faces the same general inflation, extra health care inflation, and growth in services-per-patient faced by Medicaid. Private plan cost increases were about 13% in 1991. Medicaid could show larger increases because of recession-related growth in recipients and extraordinary reimbursement rate changes because of Boren Amendment litigation. Assuming special factors would bring normal apples-to-apples Medicaid spending increases to 16-17%, the 32-33% estimates imply an equal amount of the Medicaid increase will be for what amounts to fiscal relief -- funding costs previously covered by 100% in-state money and retroactive claims. If only a third of the 1991 federal aid increase of 32% went for this purpose, the state fiscal relief was $5 billion.

Medicaid revenue increases aren't showing clearly in state numbers. Many states aren't treating the provider revenues from taxes and donations as general fund revenues, much less general fund tax increases. They are *not* in the tax increases reported by the Center for the Study of the States and are in NASBO and NCSL numbers only for states that elected to consider them as tax increases. Some states treat them off-budget and some apparently consider them as offsetting receipts. This can lead to reporting them as spending cuts rather than tax increases, as New York officials did in their new budget.

Look for confusion and chaos in Medicaid finance. Federal officials aren't in a good position to change the ground rules before 1993. Because this subject was recently addressed by legislation, further administrative action would be awkward even if there were no politics involved.

Politics is involved, making it hard for the Bush Administration to constrain new state financing methods before the elections. The Administration was criticized for extraordinary aid to New Hampshire at the time of the Republican primary, making it embarrassing to deny similar Medicaid treatment to other states. The Administration is likely to be attacked for not doing enough in health care for the poor. Expanded Medicaid was the President's response in 1988 and may well be part of the response in 1992, making a confrontation with state officials over cutbacks important to avoid. Finally, the Medicaid solution helps some key Republican governors who are trying to avoid tax increases.

The Congress is likely to avoid controversial legislation in any field before elections. Because the budget control legislation treats Medicaid as an entitlement protected from control and competition with other spending, there is no built-in motivation to worry about sharply escalating cost except general concerns with the federal deficit.

In this environment, state officials face a large open door to the federal treasury. That door will probably close as similar doors to 100% federal cost sharing (e.g., special education, mass transit operating costs, and social service grants) have closed.

The argument for rushing through the door -- with as much provider financing as possible, liberal Medicaid eligibility and services, and higher provider reimbursement rates -- is the immediate benefit to a state's economy, budget, and the health of its people. If any controls subsequently enacted contain hold harmless provisions, another argument for going through the door is that it could be closed to states not acting. Conversely, it is easy to envision scenarios where states become committed to extremely expensive Medicaid policies only to watch the federal support that encouraged them disappear.

Federal regulations to implement last year's legislation haven't yet been issued. It is difficult to predict when they will be.

PROMISES, PROMISES

Faced with difficulties in passing appropriations calling for increased spending or reduced revenue, **legislatures are passing more tax reductions and spending increases with future year impacts.** They may never be implemented.

Doing something today for which costs will not appear until tomorrow is not a new idea. Some mechanisms are common and reasonably respectable, such as financing capital outlays by borrowing and passing stiffer sentencing laws without budgeting for increased corrections costs. Another time-honored practice is *letting the camel's nose under the tent.* {The argument is that if you let the nose in, the entire camel will soon follow.} It is a classic argument against appropriating money for designing public works without appropriations for construction and against allowing programs to begin that inherently involve increasing costs over time. Another common case is phasing in a cost so that its full impact isn't felt until the next fiscal year. One example is budgeting a staffing increase to occur in the middle of the fiscal year, which means costs in the second year double. A pay raise effective at mid-year has the same impact.

Reimbursement programs create rights to payments in a subsequent fiscal year. These were a common device in some forms of school aid, particularly special education, and are inherent in programs in which states pay, or share in paying, deficits incurred by activities like local mass transit. These programs make spending uncontrollable and unpredictable. When 100% or nearly 100% reimbursement was involved, they also encouraged rapid spending increases. State officials couldn't control them by budget decisions because the appropriations were a reimbursement due for past activity. These devices have been eliminated from most state budgets except for entitlements like Medicaid. In a sense, revenue-reducing tax deductions and, especially, tax credits, are reimbursement programs even though no cash outlays are involved. A few states have tried to control these in the industrial development field by requiring prior authorization of spending for which a tax credit will be claimed.

Future appropriation commitments have become common, particularly in education, where the response to school equalization concerns has often been multi-year programs to provide equalization without cutting aid to any district. Also, such expensive quality measures as reducing class sizes and expanding pre-school education have often been enacted for future implementation. When the bill comes, state officials often opt to postpone the improvements, as has happened in Colorado and Georgia among other states.

Future tax cuts are also common. One version is the *temporary tax*, which is not an oxymoron, but is often little more than an aspiration. In some cases, such as the Louisiana sales taxes of the late 1980s, the temporary characteristic has lost its meaning. But in others, such as the Illinois income tax increases scheduled to expire in 1991, renewal can become an issue in campaigns. There are enough examples of temporary taxes that have been temporary to lend credence to the idea, particularly when the tax is tied to a one-time expenditure. An example was the temporary tax adopted in Missouri to handle refunds under the Davis case on equitable treatment of state and federal retirees.

Scheduled future tax reductions have a justified bad reputation. New York has been postponing its income tax reductions for years. Virginia's postponing a reduction in the sales tax on prescription drugs was just one of this year's growing number of examples.

The latest examples are comprehensive approaches to health care financing that appear unlikely to be implemented. The granddaddy was the Massachusetts universal care plan showcased by Governor Dukakis in the 1988 Presidential campaign. Massachusetts elected officials recoiled at the prospect of $1,000 a year per-employee taxes on employers. But the reaction came after enactment, rather than in debate over enactment. Maine adopted a less sweeping plan which is also not being implemented.

The newest plan, in Minnesota, is considerably more modest. If it works as designed it will cover just under 40% of the uninsured, will demand substantial premium payments from users in the income range of $20,000 to $40,000, will have less complete coverage than the typical large employer health plan, and will involve no payroll tax. The taxes to support it, primarily a 2% levy on health care providers, aren't scheduled to go into effect until next year. With its modest aspirations, the plan runs less risk of not being implemented, but more risk of not solving enough of the health financing problem to satisfy its sponsors. The primary risks to implementation are a combination of: (1) less voluntary participation than predicted and (2) diversion of the provider taxes to finance Medicaid in the tight fiscal circumstances predicted for Minnesota's next biennial budget.

California legislators have never been able to agree on a comprehensive health financing plan, but did conclude that cost was a major barrier preventing small employers from adopting plans. So legislation was passed to provide a tax credit that would offset 25% of the health plan costs of small employers up to $25 per employee-month.

The credit was adopted in 1988 for future effect. As the future was becoming the present, the legislature acted in 1989 to postpone the effective date to 1992. In 1991, the start date was extended to 1993. Now, as 1993 approaches, the bill to extend the date to 1994 has been reported out of committee. Prospects for passage are good as all major plans for the budget assume implementation will be postponed.

MEASURING STATE FINANCES

NCSL and NASBO agree that nine states had no tax changes in 1991. But Steven Gold asks,

> *Guess how many other states there were for which they reported the same increase or decrease?*
>
> *Would you believe one?*

Major Surveys Differ: Just about everyone would agree that the best numbers on state finances: (1) come from an objective source and (2) use the same concepts and definitions for each state. Only the Census Bureau statistics meet this test. But they are slow. FY 1990 data released last fall are the latest available for debating FY 1993 budgets. Also uniform definitions aren't always best. When a governor claims 30 other states have deficits, he wants the back-up to be 30 governors with admitted deficits, not five admitting deficits and a statistician claiming another 25 have deficits they don't admit.

The two "official" surveys of state finances, NCSL's and NASBO's, have one compelling advantage. Their numbers are verifiable by offices in individual states and the details behind them are knowable. That is, someone can explain where the numbers came from, what assumptions are involved, and what policies are presumed in them. To achieve congruence with their member's numbers, NCSL and NASBO report different numbers when the legislative and executive in individual states disagree, as they often do.

They also report inconsistently when states aren't consistent. For example, in 1991 the state tax administrators (FTA) reported that at least 29 states gained revenue from conforming to federal changes in how deductions for high income taxpayers are handled. So how many should be counted? Choices: (1) all 29, (2) the 14 FTA reports acted by legislation rather than administrative action, (3) the eight reported by NCSL, (4) the six reported by NASBO, or (5) the zero used by Gold's Center for the Study of the States. When the organizations impose common definitions, they do it differently. Extending a "temporary tax" constitutes a tax increase for NCSL, but not for NASBO, Gold, or State Budget & Tax News. The massive increases in health care provider taxes are reported as tax increases in some states and not others. NASBO and NCSL follow the inconsistencies. Gold and the Census Bureau exclude all of them. SB&TN reports them all as increases.

Conflicting Results: The table shows some extreme examples of the differing pictures of 1991 tax increases presented by the Center and the two state organizations.

Three Views of Tax Increase In 1991 ($ million)

State	NASBO	NCSL	Center
Alabama	$22	$172	$0
California	5,691	6,393	6,393
Illinois	144	732	27
Louisiana	-14	315	0
Massachusetts	-156	-215	-40
New Hampshire	0	62	39
New York	817	1,200	800
Texas	1,058	852	852
TOTAL US	$15,031	$16,320	$14,536

Pretenders To The Throne: Several groups have tried to reap the publicity of providing information, and sometimes rankings, of 50 states' finances. Their materials aren't generally used in serious forums, such as legislatures, because they do not explain where the numbers came from and how they entered any rankings in sufficient detail so that others can replicate the calculations. The Tax Foundation numbers on state tax increases are an example. So are the numbers appearing in City & State's 7th Annual Financial Report on states (4/20). Its numbers differ wildly from NASBO's. For example, NASBO reports a national total general fund balance ending FY 1991 of $3.0 billion while C&S reports $5.6 billion. For FY 1992, the comparable numbers are $4.4 billion and $0.3 billion.

Another Junk Ranking, State Fiscal Strength: The new C&S ranking of states "according to their fiscal strengths" doesn't merit much attention. The methodology can't be replicated or even reviewed because it isn't spelled out in detail and because data sources aren't clear. It will get attention, as just about any such survey does, because incumbents in high-ranked states will use it as vindication and challengers in low-ranked states will use it as justification for removing incumbents.

Not knowing exactly what "fiscal strength" is, judging the rankings is hard. One view of fiscal strength would be net worth. Winners would be states with massive reserve funds like **Alaska** (ranked #27), **Wyoming** (#5), or **Texas** (#13). High ranks would go to states with no debt (as C&S measures it) like **Iowa** (#42) and **Colorado** (#36) as well as **Nebraska** (#2) and **South Dakota** (#3). Also good is having no unfunded pension liability like **Iowa** (#42) as well as **Tennessee** (#1) and **Delaware** (#3). Bond ratings don't help much. **Maryland** (#35) is AAA as is **South Carolina** (#29). Having a large rainy day fund and general fund balances helps **Nebraska** (#2) but not **Oklahoma** (#44).

The C&S loser is **Connecticut** despite enacting a large new income tax. The winner is **Tennessee** despite nationwide publicity for near bankrupt school districts and legislative rejection of an income tax the governor insists is necessary for solvency. If the award is really given for "stability," **Reports** would award it to states resistant to changes in their fiscal patterns like **Georgia**, **Indiana**, and **Utah**, which C*S ranks between 19th and 29th.

TECHNICAL NOTES

State Finances: The Ohio quotes (slightly paraphrased) come from Richard Sheridan in the March issue of the newsletter The Budget $cene in Ohio (Federation for Community Planning, 614 Superior Ave., N.W., Cleveland, OH 44113). The Center for the Study of the States (411 State St., Albany, NY 12203) publishes quarterly summaries of state tax collections in State Revenue Reports. The February edition is the basis of the numbers in the article. In the table showing successive fiscal surveys, **Reports** subtracted $2.2 billion in FY 1991 and $2.4 billion in FY 1992 from the reports of the April 1991 survey to reflect approximately the amounts of federal aid that Illinois included in general fund totals in that survey but appears to have excluded from subsequent reports.

Cascading Fiscal Problems: The Indiana material is from the February Fiscal Policy Bulletin of the Indiana Fiscal Policy Institute (251 N. Illinois St., Indianapolis, IN 46204). The Wisconsin material is from the Wisconsin Taxpayers Alliance (335 W. Wilson St., Madison, WI 53703) newsletter, Your Wisconsin Government (3/13). The one-time measures finally adopted are larger than those described. **Reports** takes some liberty with local fund definitions to make fiscal information intelligible outside the state of origination.

State And Federal Fiscal Performance: The comparative deficits chart reflects quarterly results at seasonally adjusted annual rates, using national income accounts concepts, as presented in the Survey Of Current Business (March). Adding retirement funds would reduce the federal deficit, for example, by $36.7 billion in 1991 IV. A comparable adjustment would put the state and local sector in surplus by $40.4 billion. A state and local deficit is common because borrowing for capital outlays exceeds repayment on past bond issues. In **Reports**, fiscal years are designated FY and years without a prefix are calendar years.

Measuring State Finances: Gold's assessment appeared in "How Much Did State Taxes Really Go Up In 1991?" published by the Center for the Study of the States.

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STATE POLICY REPORTS

VOLUME 10 ISSUE 10

IN THIS ISSUE

Many states are going to great lengths to get through November without major tax hikes or spending cuts, despite continuing revenue shortfalls and spending overruns. Tax cut proposals are alive, but not well.

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Recent riots, earthquakes, and droughts are just a sample of California problems identified by a "competitiveness" panel. The group is urging more pro-business policies.

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As the richest states falter, other states are raising per capita incomes closer to the national average.

- Changing Economic Fortunes p. 10

If state policies change with changes in voter profiles, policies must increasingly respond to those over 45.

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Tight finances are a drag on action in education. Signs of educational failings remain along with determination that state action will correct them. Measures comparing states remain tentative and controversial. The pace is slow in implementing education reforms and experimenting with school choice.

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May 1992 (Second Of Two May Issues)

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FISCAL POLICY UPDATE

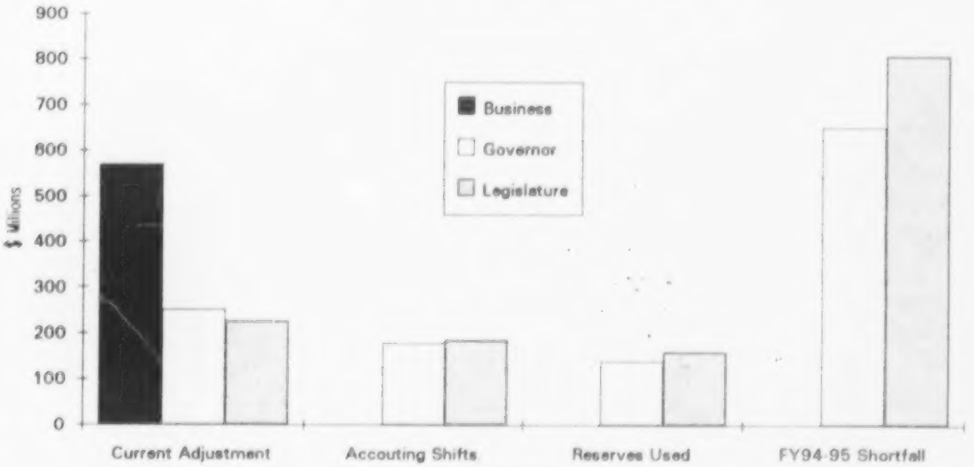
By normal standards, this would be a year for major state actions on taxes. A recent National Conference of State Legislatures report, NCSL State Budget Update: April 1992, concludes: (1) three-fifths of the states have FY 1992 revenues below estimates on which budgets were based, (2) revenue estimates for FY 1993 suggest growth "near or below the inflation rate," and (3) three-fifths of the states have FY 1992 spending overruns.

In other words, most of the returns are in on FY 1992 with widespread worse-than-predicted results. The outlook for FY 1993 isn't good either. **Sooner or later something has to give.** Spending patterns need to be cut sharply. Or taxes need to go up. Neither appears to be happening for reasons discussed in detail in Issue 9.

Deferring Problems, Minnesota Style

A good indication of what appears to be happening throughout the country comes from a summary of the already completed Minnesota legislative session developed by the Minnesota Business Partnership. **Reports** used it to create the chart below. Minnesota's case is particularly useful because the contending players seem to agree on numbers. This isn't common in debates on fiscal strategy, particularly those involving shifts to future years.

Dealing With Minnesota's FY 1992-93 Shortfall



Minnesota enacted a budget for the FY 1992-1993 biennium in its 1991 legislative session. For the same reasons affecting other states, it developed a shortfall of $569 million in that budget, requiring action in the 1992 session.

The Partnership argued that the state should make adjustments to spending patterns to maintain a balanced budget without touching the planned year-end reserve of $400 million. A strict balanced budget posture would accept any combination of tax increases and spending cuts that reestablished balance on a current basis. As shown by the chart, the governor recommended that less than half the problem be handled by current adjustments. The legislature reduced this amount.

To avoid major changes in spending patterns or taxes, the governor and legislature agreed to use accounting changes and draw down reserves. One effect, shown in the final column, is that the current service deficit for the next biennium is over $800 million. It would have been zero if the adjustments had been made by permanent spending cuts and/or tax increases.

While taking these actions in the regular budget, Minnesota was committing large sums outside that budget. Its HealthRight plan will be financed primarily by $176 million of medical provider taxes plus $18 million each from increases in taxes on cigarettes and insurance premiums. Taxpayers won't see the taxes until after the elections. The major impacts of spending won't arise until the next biennium.

As was the case in other states, the final count of spending reductions included many items that would not be considered lower spending in standard definitions. The largest single item in the $187 million of spending adjustments was the repeal of sales tax exemptions for local governments. Another item was an $11 million reduction in health care which presumably reflects increased spending on HealthRight.

Tax Policies On Hold

As the state-by-state summary shows, moves to increase state revenues significantly are rare so far.

This assessment in a new NCSL report on state finances reflects the strong aversion in state legislatures this year to changes in state tax systems. The prevailing view, so far, seems to be to avoid tax increases in the regular legislative sessions even at the price of pushing massive fiscal problems into lame duck sessions in December and regular sessions next year (see Issue 9). Sharp spending cutbacks are also being avoided.

Major tax restructuring is on the agenda now in only three ~~states.~~ Alabama is still working on a massive revision package. Nebraska and Texas are forced into considering tax revision by court decisions undermining their property tax systems.

Maryland has adopted a package of major increases and Florida officials are still fighting over one. But the other action is more like the Mississippi and Tennessee sales tax rate increases and debates over relatively minor measures in states like Ohio and Rhode Island. Elected officials in states under extreme fiscal pressure, such as California and Illinois, continue to renounce major tax increases.

A Painless Revenue Enhancement?

The giant exception to the apparent moratorium on tax increases is taxes on health care providers. These are sailing through many legislatures under what would have to be called "deep cover."

Proponents aren't calling them tax increases, which wouldn't avoid debate if the taxpayers adversely affected were challenging them.

But health care providers, particularly nursing homes and hospitals, are being promised significantly higher reimbursement rates and avoidance of cutbacks in Medicaid-eligible recipients and services if they support the increases. So they often aren't opposing them. Organized business and organized labor both fear paying more through 100% in-state payment of uncompensated care than from Medicaid funding cost-shared with the federal government. So they generally aren't opposing them either. Statehouse reporters are equipped to write day after day on disputed minor revenue increases, but not to cover major increases that don't generate disputes.

Bucking The Trend With Tax Cuts

The three major tax cut initiatives by state elected officials this year aren't going well.

In **Massachusetts**, tax revenues are outperforming expectations despite direful performance of the state's economy. But non-tax revenues, like asset sales and refinancings, aren't working out well. Nor are expectations for some of the planned spending cutbacks. Local finances, the source of many state savings, are showing increasing signs of strain. The governor is continuing his push for tax reduction.

In **Michigan**, the state's budget is in awful shape, but the governor (R) and legislative leaders (D&R) continue to push alternative plans to cut property tax burdens.

In **New Jersey**, the legislature's majority (R) has sent a one-cent reduction in the sales tax to the governor (D). The majority is large enough to override a veto and will probably do so if the governor makes it necessary.

The next move is financing the sales tax reduction in a budget probably not balanced even with revenues from the tax. An obvious target is a massive property tax rebate. Money from the 1990 tax increase was used to expand it to renters and to a maximum of $500 a household. Democrats, with help from senior citizens, are defending the rebate with brochures and radio ads, "They're after your money and they know where you live." Democratic legislators are wearing lapel pins asking, WHO GETS CUT?

In May, the state treasurer indicated that disappointing revenues have led to a shortfall of $342 million in a state budget of about $15 billion. Rolling the bad news forward indicates a similar shortfall in the governor's FY 1993 budget proposals which already presume that the sales tax will not be reduced.

The governor's proposals presume that the federal government will provide $380 million in extra income from retroactive Medicaid payments, with no corresponding increase in state spending. One source of apparently painless savings, reducing retirement contributions, is also already reflected in the budget submitted by the governor.

Voter-Forced Tax Cuts In Oregon

The winner among tax cutting efforts this year may be voter-initiated Measure 5 in Oregon. It requires reductions in property taxes and mandates the state to make up the loss in school revenues. The governor has held nationally publicized CONVERSATIONS WITH OREGON voters. But she found little interest in the obvious financing source, a sales tax, which voters have rejected eight times in the past 60 years. Anticipating disaster in the next biennium, the governor has announced she will cut state employment by 4,000 workers in the next 18 months.

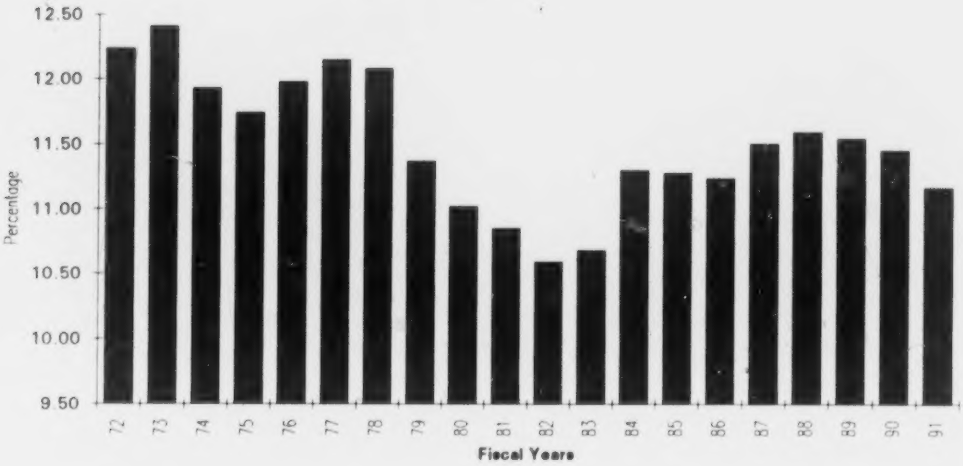
Despite her avoidance of tax increase proposals, the governor is under heavy fire from many different directions. In May, leaders of a movement to recall her under the state's direct democracy procedures presented petitions which they claimed would produce the necessary 167,000 valid signatures (15% of the vote for governor in the last election). The signature requirement apparently wasn't quite met, avoiding a recall election this summer.

Discontent comes from many unrelated directions -- abortion foes unhappy with her pro-choice stance, those interested in spending who object to spending cuts and her unwillingness to campaign for a sales tax, and timber interests who don't think she has stood tall enough for the industry against environmental challenges (like saving the spotted owl) that are curtailing logging.

Stable State and Local Tax Levels

Though arguments over changes in taxes and spending provide annual crises in state and local governments, when the shouting stops the nationwide results remain remarkably constant from year to year. The percentage of personal income taken by state and local taxes has stayed in a narrow band of 11-12% for the past two decades. The fluctuations above and below this range are emphasized by the chart. They result primarily from the impacts of business cycles on both personal income and the yields of state taxes, even when rates remain unchanged.

State And Local Tax Revenue
Percentage of Personal Income



The percentage of these taxes that are raised by state governments rose from about 55% in 1971 to just over 60% in the early 1980s. Since then, it has dropped to about 60%. Conflicting forces are at work. The state share has been increased by assumption of formerly local responsibilities for welfare, social services, health, and the courts and by the moves to increase the state share of education spending. But many states are now forcing cities and counties to take more responsibility for raising the money they spend and giving them access to sales and income taxes. Both actions have tended to increase the local share.

The net effect of state actions to deal with recession will likely further increase the local share. Many states have curtailed the growth in state school aid while cutting back on general local government aid. Recession typically takes its toll on the state sales and income tax base much more quickly than on the local property tax base, particularly in states where assessment changes lag property value changes.

CALIFORNIA WOES

We started out being worried, and we ended up with the conclusion that things were much worse than expected and much worse than you know. We're on the precipice and about to drop off.

This was just one of the depressing comments by Peter Ueberroth (successful businessman, former baseball commissioner, and manager of the Los Angeles 1984 summer Olympics) as he presented the report of his Council on California Competitiveness at a press conference in April. Just about every aspect of California's public policy picture has been coming up ugly lately.

The Economy And State Policy

Through much of the 1980s, California's economy so consistently outperformed national averages that revenue estimates were based upon what amounted to adding a percentage point to projected national growth rates. **California's superior performance has ground to a halt.** Unemployment in March was 8.7%, well above the national average. Other indicators of economic performance have dropped below national averages.

No one knows how much state action and inaction has contributed to the problem. **Business leaders and Governor Wilson believe state government's impact has been substantial and negative.** Wilson, who joined the press conference on the competitiveness report, commented, "Over the period of a couple of decades, we have imposed, cumulatively, a job-killing burden on the ability of California employers to compete." Critics contend the state compares unfavorably with competitors, particularly for manufacturing jobs, in such factors as business taxes generally, Workers' Compensation taxes and policies, tort liability, environmental regulation substance and processes for resolving issues, and government-influenced costs of housing and health care. Observers inside California and out view the state as mobilizing much less well than other states for interstate development competitions such as those for the supercollider project.

The Physical Environment

California's environment has been its developmental long suit with assets ranging from climate and excellent ports to fine locations for high value agriculture. But, **rapid population growth has magnified the constraints of the environment.** The constraint of limited water in Southern California was overcome by extensive investments in dams and aqueducts. Demand has now outrun supply, with the recent drought highlighting the problem, not causing it. The many proposals over several decades to bring more water from the North have been stalled in controversy. Whether done by rationing and allocation mechanisms or by market pricing, the result is likely to be less water for agricultural uses.

The airflows in metropolitan areas, particularly around Los Angeles, don't easily dispose of air pollution. As a result, California already has stiffer (and more expensive) standards for industry and vehicles than other states. There are widely publicized proposals for further restrictions that would increase the costs of doing business as well as cramp lifestyles (e.g., fireplaces and barbecues).

Demographics And Migration

Demographic factors are extremely unfavorable for California's finances. The primary culprit has been migration, both legal and illegal. It quickly translates into social welfare costs (though there is substantial dispute over whether the economic contributions of migrants outweigh these costs) and into education costs associated with burgeoning enrollments. The Ueberroth report assesses the situation by starting with an annual population gain of 600,000 people a year, requiring an increase of about 250,000 jobs a year to provide the revenues to cover the added cost. It is difficult to imagine how the state's economy would grow at that pace, particularly given the loss of an estimated 340,000 jobs in the past year.

State Finances

While there is dispute among experts over whether all states face them, there is little question but that **California has a large, persistent structural budget deficit**. Besides unfavorable demographics, its laws simultaneously curtail revenue growth (e.g., indexing the state income tax for inflation, Proposition 13 limits for local taxes) and mandate spending growth (e.g., Proposition 98 guarantees of state education spending, indexing payments under many programs for inflation). Governor Deukmejian was fond of saying that if California finances were left on autopilot, spending would grow 11% a year while revenues grew 7% a year.

Last year's tax increases and spending restraints clearly didn't solve the problem. The governor's budget announced a new deficit. Since it was issued, all concerned agree that it understated the size of the problem. Ueberroth characterized the problem as "an exploding shortfall" and predicted "California will run out of money in a dramatic way right around the corner." On a budget accounting basis, current estimates of the end-FY 1992 deficit range from $4 billion to $7 billion, as much as 10% of the budget. The controller is warning that a "sea change" in state finances means the state will also have a cash flow problem as early as June.

Legislative consideration of budget issues has bogged down. Majority Democrats in the legislature are trying to blame the Republican governor. The governor is appealing over the heads of the legislature to the electorate. The outcome is in doubt. The effect of the process isn't. The impression is not one of officials in control of the situation disputing details of how to handle it, but one of officials not in control of the situation.

The Political Process

The California political process, as distinct from the resulting policies, is a cause of adverse business perceptions. Heavy use of the initiative means that policies clearly less favorable to business than the legislature itself would likely adopt are constantly a possibility.

The process can also lead to concerns that state government overall (including the voters legislating by initiative) is inept. While **Reports** knows of no empirical basis to support such a conclusion relative to other states, anecdotally it isn't hard to find problems. For example, all of the state's insurance reforms have gone awry. Solvency regulation hasn't prevented company insolvency. The promise of lower rates from Proposition 103 has not been realized. Legislation to provide earthquake insurance coverage has so many problems the insurance commissioner has recommended that the whole program be scratched.

Education

The competitiveness panel was highly critical of California's public schools: "Our schools have become one of history's great social experiments -- and the experiment is not a success." The Sacramento Bee (4/27) succinctly summarized the criticisms:

> *Too many kids can't read. Too many drop out. Nobody accepts the blame. Taxpayers aren't getting their money's worth. Businesses can't find well-trained applicants.*

In public schools, California has opted for the second largest class sizes in the nation and the fourth highest teacher salaries. This unique combination permits state per-pupil spending below the national average. The higher education system has long been known for its accessibility, with a comprehensive community college and university system available at comparatively low costs to students. Enrollment pressures have made courses harder to get and fiscal pressures have caused sharp tuition increases at all levels.

The Proposed Solutions

The Ueberroth report recommendations read much like business community recommendations for governmental change in other states. Its major features are (1) tax breaks for business including lower capital gains taxes and tax incentives for job creation, (2) Workers' Compensation reform, (3) tort law reform, (4) more expeditious handling of environmental and land use permits, (5) improvements in the schools, including lengthening the school day and school year and an education choice plan.

CHANGING ECONOMIC FORTUNES

Per Capita Income

Newly released data show that, despite recent economic problems, Northeastern states continued to lead the nation in per capita personal income in 1991. They reflect the concentration of economic growth through much of the 1980s on the seacoasts, the "Bicoastal Economy." Among the top 13 states, only Illinois (#10) doesn't border an ocean. Southeastern states lag, as they have since the Civil War. However, Idaho, New Mexico, Utah, and West Virginia are also in the bottom ten.

Per Capita Personal Income, 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Connecticut	$25,881		**United States**	**$19,082**	34	North Carolina	$16,642
2	New Jersey	25,372	18	Florida	18,880	35	Arizona	16,401
3	Massachusetts	22,897	19	Rhode Island	18,840	36	South Dakota	16,392
4	New York	22,456	20	Michigan	18,679	37	Tennessee	16,325
5	Maryland	22,080	21	Kansas	18,511	38	North Dakota	16,088
6	Alaska	21,932	22	Wisconsin	18,046	39	Montana	16,043
7	Hawaii	21,306	23	Ohio	17,916	40	Oklahoma	15,827
8	California	20,952	24	Nebraska	17,852	41	Alabama	15,567
9	New Hampshire	20,951	25	Missouri	17,842	42	Kentucky	15,539
10	Illinois	20,824	26	Vermont	17,747	43	South Carolina	15,420
11	Delaware	20,349	27	Oregon	17,592	44	Idaho	15,401
12	Virginia	19,976	28	Iowa	17,505	45	Louisiana	15,143
13	Washington	19,442	29	Georgia	17,364	46	New Mexico	14,844
14	Colorado	19,440	30	Maine	17,306	47	Arkansas	14,753
15	Nevada	19,175	31	Texas	17,305	48	Utah	14,529
16	Pennsylvania	19,128	32	Indiana	17,217	49	West Virginia	14,174
17	Minnesota	19,107	33	Wyoming	17,118	50	Mississippi	13,343

The disparities among residents of different states in purchasing power is somewhat less than the disparities in per capita personal income. Federal income and Social Security (FICA) taxes take larger bites out of personal income in the more affluent states than in the poorer ones. Per capita state and local taxes are also generally higher in the affluent states. A case can be made that prices are also higher in affluent states, though consistent and reliable data comparing price levels haven't been available since the federal government stopped collecting such statistics a decade ago.

With a common currency and free movement of goods, capital, and labor, one would expect disparities among states to level out over time. This concept, *the convergence hypothesis*, is amply supported by what has happened in the United States from decade to decade, but not by changes during much of the 1980s.

Per Capita Income Changes

Convergence has reappeared as shown by the recent changes in per capita income in the table below. Its low-ranked states reflect the puncturing of economic development bubbles in Arizona, California, Nevada, and New England, as well as slower growth in formerly rapid growing Florida, Georgia, Maryland, and Virginia. The leaders in recent growth include many of the low per-capita-income states such as the Dakotas, Louisiana, and West Virginia.

Percentage Increase In Per Capita Personal Income, 1988-1991 and 1990-1991

Rank	State	88-91	90-91	Rank	State	88-91	90-91	Rank	State	88-91	90-91
1	North Dakota	28.8%	4.8%	18	Oregon	17.3%	2.4%	34	New Jersey	14.3%	2.0%
2	South Dakota	27.0	3.2	19	Nebraska	17.1	2.1	35	Missouri	14.2	2.1
3	Hawaii	25.2	4.6	20	New Mexico	16.9	4.1	36	Maine	13.8	0.7
4	Montana	24.0	4.8	21	South Carolina	16.6	1.8	37	Vermont	13.5	1.4
5	Wyoming	21.5	5.1	22	Colorado	16.6	3.1	38	Florida	13.4	1.8
6	Louisiana	20.1	4.2	23	Oklahoma	16.6	2.4	39	Delaware	13.4	1.3
7	Kentucky	19.4	3.6	24	Pennsylvania	16.5	2.4	40	Maryland	13.2	1.0
8	Idaho	18.9	1.0	25	Wisconsin	16.4	2.6	41	Michigan	13.1	1.6
9	Utah	18.9	3.9	26	Illinois	15.9	1.9	42	Virginia	13.0	1.4
10	Alabama	18.4	3.8	27	Kansas	15.7	2.2	43	Georgia	12.9	1.9
11	West Virginia	18.4	3.1	28	Minnesota	15.7	2.0	44	Connecticut	12.7	1.9
12	Arkansas	18.3	4.1	29	New York	15.7	1.5	45	California	12.1	1.3
13	Washington	18.2	3.5	30	North Carolina	15.7	2.3	46	Nevada	11.6	0.7
14	Mississippi	17.9	4.0	31	Tennessee	15.6	2.9	47	Rhode Island	11.3	0.2
15	Iowa	17.7	1.2		**United States**	**15.0**	**2.1**	48	Massachusetts	11.1	1.5
16	Alaska	17.7	1.3	32	Indiana	14.9	1.7	49	Arizona	11.0	2.5
17	Texas	17.5	3.5	33	Ohio	14.6	2.0	50	New Hampshire	7.8	0.9

From 1988 to 1991, top-ranked Connecticut's advantage over the national average fell from 38% to 36%, second-ranked New Jersey's from 34% to 33%, and Massachusetts dropped from a 24% lead to a 20% lead. Lower ranked states were closing from the bottom. As a group, the bottom ten states moved from 75.6% of the national average in 1988 to 77.9% in 1991. Every state in this group moved closer to matching the national mark. In the past year, per capita income in the bottom ten states rose 3.4% while the increase was just under 2% for the average state in the top ten.

The one-year changes are generally consistent with the three-year changes, with the worst performances in New England and Nevada. The bad news in the one year changes is that national growth (and growth in 43 states) was below the 4.1% inflation of the past year. Put another way, purchasing power declined in 1991, the first year it has done so since 1982, which was also a recession year.

Food Stamp Participation: Participation in the Food Stamp program highlights the differing performance of state economies even more than changes in per capita income. About 25 million Americans used Food Stamps in January, nearly one out of every ten. As would be expected, participation rates (States In Profile, Table H-10) are highest in the states with the lowest per capita incomes. However, there are dramatic differences in the changes in the number of recipients. The table shows the states with the largest and smallest changes.

Percentage Increase In Number of Food Stamp Recipients, January of 1991 and 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Florida	46.2%	8	Indiana	21.6%	44	Kentucky	7.8%
2	Nevada	31.1	9	Alaska	20.3	45	Illinois	7.4
3	New Hampshire	29.6	10	Arizona	20.0	46	Arkansas	7.2
4	Delaware	27.1		**United States**	**14.0**	47	South Dakota	6.2
5	Virginia	25.7	41	Hawaii	8.9	48	Mississippi	4.3
6	New Jersey	23.6	42	Iowa	8.9	49	Louisiana	3.3
7	Connecticut	21.8	43	Nebraska	8.1	50	Michigan	1.4

The states with the most dramatic increases are those with high per capita incomes, often states that were economic success stories of the 1980s. The smallest increases are found in lowest per capita income states, including bottom-ranked Mississippi, and in states that faced 1980's crises in the auto industry (Michigan) and agriculture (Iowa and Nebraska).

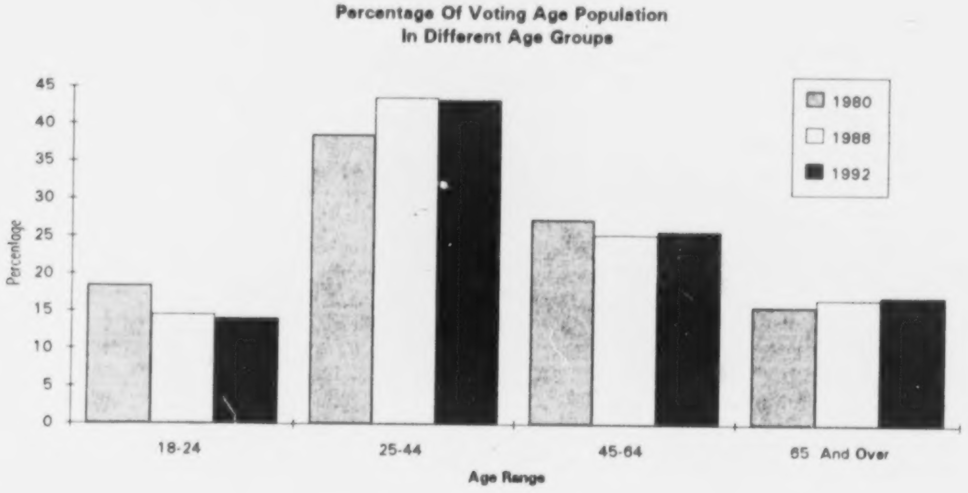
WHO VOTES

> *In advocating* [insert policy position], [insert candidate name] *is keeping his eye on where the votes are.*

This is a kind of generic quote about candidates' positions on issues that journalists use routinely, as CBS News did (5/9), to reflect the widely accepted theory that elected officials keep an eye on who votes when adopting policies. What does that eye see? In most states, a rapidly aging electorate.

The Census Bureau recently estimated that about 189 million Americans will be of voting age this November. Ten million can't vote because they aren't U.S. citizens. Many more won't vote even though qualified to do so. About a third of the voting age population cast ballots for Members of Congress in the 1990 elections while only half voted for President in 1988, down from 53% in 1988 and from over 60% in the 1960s.

The rapid aging of the voting age population is shown by the chart. In November, 42.8% of potential voters will be 45 or older, a percentage that will climb rapidly as more post-World War II baby boom children pass age 45.



The age profile of the electorate varies considerably by state. The table below shows the percentages of potential women voters in selected large states. Utah and West Virginia are included to illustrate the extremes. Almost half of the female voting age population is over 45 in West Virginia versus under 40% in Utah.

Percentage Of Female Voting Population By Age, 1992

State	18-24	25-44	45-64	65 And Over
US	13.0%	41.8%	25.6%	19.7%
California	13.5	45.0	24.6	16.9
Florida	10.7	36.7	26.3	26.3
Illinois	12.9	41.9	25.5	19.8
Massachusetts	13.0	41.5	24.5	21.0
Michigan	13.5	42.0	25.6	18.9
New York	12.4	41.1	26.3	20.1
Pennsylvania	12.1	38.5	26.0	23.5
Texas	14.4	44.0	24.9	16.7
Utah	18.4	43.3	22.9	15.4
West Virginia	12.4	37.5	27.0	23.1

The impact of older people on elections is greater than their share of the voting age population. Turnout increases with age, as well as with income. In the 1990 elections, about 45% of those over 50 voted while the turnout for all age groups was only 36%.

Differing age and income profiles explain much, but not all, of the differences among states in voting. In 1988, over 60% of the voting age population cast a Presidential ballot in the Dakotas, Maine, Minnesota, Montana, Utah, and Wisconsin. With turnout below 45%, compared with a national average of 50.1%, the low voter participation states in 1988 were the Carolinas, Florida, Georgia, Hawaii, Nevada, and Tennessee.

There is no state issue that has the same obvious salience for older voters as Social Security is perceived as having in national elections. However, the increasing number of older voters is widely believed to increase resistance to local property taxes. These voters don't have children in school and are most likely to experience property taxes disproportionate to their current income.

EDUCATION REFORMS LAGGING

National Education Progress Limited, Hard To Measure

> *The American people believe strongly in the power of education. The best available data, however, show our performance falls short of the standards we need to meet to compete effectively in the global economy.*
>
> *We've got to transform the way our schools are organized and what they're doing, what they're teaching, how teachers are trained, what schools look like, and how they're staffed.*

These were the comments of Governor Romer and U. S. Education Secretary Alexander on the release of the first report detailing how the Bush Administration and the governors were doing in reaching the six education goals they established a year earlier. The substance of the report was captured by headlines at the time: "Education Goals Called Far From Realization," Washington Post (10/1/91) and "Data, Strategy Said Missing In Report On Goals, But Educators Hail Effort As First Step," Education Week (10/9/91). The heavy emphasis on quantified measures of student achievement was lauded by the usual advocates and criticized by the usual critics. Like other measures, they tended to show the U.S. lagging in relation to other nations and showed substantial differences among states.

Education Reform In The Legislatures

Much of the energy focused on school reform in the last few years has shifted to school funding.

This isn't the year for large-scale education reform measures combining management reforms, large spending increases, and higher taxes -- like the ones most recently passed in Kentucky and Oklahoma. The quote above -- from the Jackson Clarion-Ledger's look at the Mississippi situation this spring (3/1) -- suggests why.

The exception is **Alabama** where education reform and tax reform are linked in one 33-bill package. Among other things, the bills alter teacher tenure, offer principals a $5,000 salary hike to give up their tenure, and limit the revenue that can be assumed in enacting a state budget to prevent downward mid-year adjustments (pro-rations) that have plagued Alabama school administrators in recent years. A proposal to end election of school superintendents was defeated. The package has passed in the House and is now in the Senate. Once passed, it needs approval by the governor for bills and by the voters in November for the many constitutional amendments required.

In calling a special session for early this year to deal with the linked proposals for education reform and a new income tax, Governor McWherter said the choices were clear, "You're either for the kids, you're for education, or you're against. It's time to put up or shut up." Legislators did a little of each. The **Tennessee** enactment is a scaled down version of earlier education reform proposals, corresponding to the scaling down of the revenue portion from a new income tax to a sales tax hike. The legislation phases out electing local superintendents, increases school finance equalization, and adopts an annual state "report card" on school performance. School-based management is emphasized to the point that the governor boasts, "No state in America will give its schools the amount of local control contained in this bill."

The clearest victory for education funding in 1992 is better understood as regaining lost ground in state education funding than capturing new ground for education reform. In 1990, **Mississippi** officials separated education funding (including inflation-related pay gains for teachers) from the rest of the budget to link BEST (Better Education For Success Tomorrow) with tax increases. For complex reasons, the tax increases never passed, so the reform package never went into effect. Responding to lower-than-expected revenues, school aid was cut last June and cut further this February. Higher education tuition jumped 16% last fall. The sales tax increase recently passed over the governor's veto was designed to salvage basic school funding, not to revive many of the BEST reforms. Without it, the legislature would presumably have adopted the funding freeze for higher education and the 1% public school increase recommended by the Legislative Budget Committee.

Ohio is more typical of what is happening in most states. The immediate concern is funding. Schools lost $78 million in mid-year budget adjustments this year. For FY 1993, the governor is seeking higher alcoholic beverage and cigarette taxes and other revenues to avoid further cuts. School finance and education quality proposals are being studied by a blue ribbon group. The objective is consideration of legislation on these subjects in 1993. The blue ribbon group in **Rhode Island** reported this spring, with recommendations for: (1) legislative reaffirmation of the oft-stated goal of 60% state funding of education costs, (2) school finance equalization, and (3) many measures to improve school performance. Prospects for enactment of the proposals this year, when the governor's budget proposes tax hikes and freezing school aid, are understandably not good.

The worst case examples are those states where the retreat from prior education reform measures has been clear and explicit. In **Maine**, the governor's campaign for lengthening the school year by five days turned into 1991 legislation that permitted school administrators to shorten the school year by up to five days to deal with state aid cutbacks. The mandatory class size maximum for kindergartens was loosened for the same reason. The state-funded statewide educational assessment test for all students in grades 4, 8, and 11 is being dropped.

New Reform Ideas Discount Legislative Roles

Money isn't the only cause for declining interest in major education reform packages in the legislatures. Legislators and governors have already invested considerable political capital and taxpayer money in long lists of reform measures adopted in the 1980s. They have many ways to assess the results, all indicating they were not dramatic. Anecdotally, there are the cross-generation comparisons that are the stuff of family gatherings. There we form impressions of whether new generations of students get better schooling and know more than we. Stronger anecdotal evidence comes from the continuing testimony of business leaders about the products sent to them by the schools. For those more quantitatively inclined, there is the stubborn resistance of test scores, like SAT scores, to increase over time and frequent assessments that the U.S. system is producing less well educated workers than those of other nations.

More sophisticated research into the results of education reform doesn't change the picture. For example, one recent assessment by a consortium of high caliber universities produced this conclusion:

> *The decade was notable for the breadth and the persistence of the movement for educational reform centered at the state and local levels. Moreover, recent test scores provide only limited and selective evidence of any increase in student learning.*

> *At a time when there is some disappointment with recent reforms and discussion of changes as diverse as national standards, choice, and restructuring, it is important to reflect on recent developments and their implication for the future.*

Heavy costs, controversial changes, uncertain progress, and a call from evaluators "to reflect" are not the stuff out of which legislative action is made. The competition for legislative attention and state money, in education and other fields, comes from many programs that offer low costs, changes without enemies, immediate and measurable results, and beliefs held by ordinary citizens and professional evaluators that the action does some good.

Another major factor discouraging legislative interest in school reform is the increasingly widespread opinion that top-down solutions, as contrasted with school-based solutions, are ineffective.

Recent events in Massachusetts are indicative of the problem. The state, with a strong tradition of local autonomy and somewhat more confidence in educational results than the in the Southeastern states that pioneered in the state reform measures, has never bought into the complete education reform agenda of the 1980s. Meanwhile, it has crimped the resources of local officials by a combination of centuries-old restrictions preventing them from using sales and income taxes, decade-old Proposition 2 1/2 limits on property taxes, and recent cutbacks in state funding of local governments, shifting much of the state's fiscal crisis to a local fiscal crisis.

In this environment, the governor (R) and legislative leaders (D) have agreed on the outlines of education reform and on a future state financial commitment. Two elements of reform are of particular interest: (1) more money for schools for traditional purposes such as teacher salaries and materials for students and (2) some version of educational choice. The question is what else the plan should include. Into this setting, the reasonably influential Pioneer Institute dropped a major 304-page report, Reinventing The Schools.

Like other recent thinking in education, the report is *not* suited for review by legislators and staff members looking for bills to pass to improve education. It's tone is to discourage, not encourage, legislative action. The press release says, "The report reviews the well-intentioned but failed interventions of the last two decades and urges that the legislature, the courts, the unions, and district administration agree to free up the schools and restore the discretion and authority of school staff to devise successful solutions." A key passage in the report concludes, "Good schools cannot be legislated."

COMPARING STATES' EDUCATIONAL ACHIEVEMENTS

Some progress is being made toward the objective of making available quantitative comparisons of state achievements in education. The obstacles remain disagreement over what measures are appropriate and refusal of some states to participate in the use of whatever measures are available, despite inadequacies.

The table provides state rankings based on several education indicators. The three measures are: (1) the percentage of adults who have finished high school, (2) Scholastic Aptitude Test scores adjusted for the percentage of students taking the test, and (3) scores on a new test of math proficiency taken by eighth grade students (see Technical Notes for details).

State Rankings In Educational Achievement
Percent H.S. Graduates, Scholastic Aptitude Test (adj.), and Math Proficiency

Rank	State	Grads	SAT	Math	Rank	State	Grads	SAT	Math
1	Iowa	9	2	2	26	Pennsylvania	33	30	12
2	Minnesota	5	6	4	27	Missouri*	35	19	
3	North Dakota	16	3	1	28	Virginia	38	25	13
4	Kansas*	13	4		29	Arizona*	22	34	
5	Montana*	8	7		30	Hawaii	11	35	27
6	Washington*	2	16		31	California	24	31	23
7	New Hampshire	12	1	9	32	Indiana	26	42	15
8	Oregon	7	9	8	33	Maine*	32	29	
9	Nebraska	14	14	3	34	Ohio	28	33	20
10	Wisconsin	17	11	5	35	Tennessee*	48	13	
11	Alaska*	3	21		36	Michigan	31	39	17
12	Connecticut	21	8	6	37	Rhode Island	40	26	21
13	Colorado	10	12	14	38	New Mexico	37	23	29
14	Massachusetts*	20	10		39	Florida	27	40	26
15	Vermont*	15	18		40	Oklahoma	36	36	24
16	New Jersey	23	17	7	41	Kentucky	49	28	28
17	Wyoming	4	32	10	42	Georgia	42	46	22
18	Illinois*	30	5		43	Texas	39	45	25
19	Maryland	18	15	16	44	Louisiana	43	37	34
20	Utah*	1	38		45	North Carolina	41	48	32
21	Delaware	19	22	19	46	West Virginia	45	47	30
22	Idaho	29	24	11	47	Arkansas	47	44	31
23	Nevada*	6	41		48	South Carolina*	44	49	
24	South Dakota*	25	27		49	Alabama	50	43	33
25	New York	34	20	18	50	Mississippi*	46	50	

The overall rankings are based on an average of the other rankings shown. They are based on two, rather than three, ranks for designated states (*) because education officials of those states have successfully continued to resist comparative numbers. As is easily seen, the state ranks on one measure are closely correlated with state ranks on the others, with a few exceptions. For example, California is about average in all three measures. Southeastern states are consistently low on all three. Iowa and Minnesota are in the top ten in all three.

Many people don't like numbers like these. They clearly don't indicate how good a job public schools are doing with the material sent to them by families. But **Reports** considers them a decent indicator for some purposes. For example, the chances that a higher percentage of high school students and adults chosen at random from Iowa or Minnesota could understand this article are considerably greater than a comparable group of Alabama or Mississippi residents. The state rankings are similar to those found on the Armed Forces Qualification tests -- uniform tests given to new military personnel.

CHOICE EXPERIMENTS LAGGING

Choice As A Quiet Issue

Concerns that the best efforts to reform education from the top down aren't working, combined with preferences for private suppliers, have generated considerable interest in educational choice plans. **The logic of choice supporters is that the best discipline for the public schools will come from competition with private schools.**

If state officials bought this logic, they would provide per-student subsidies for private schools approximating the costs they avoid from not funding the same students in the public schools. However, this policy would be extremely expensive because it would pay for both: (1) students diverted from public schools and (2) a much larger group of students who would attend private schools without the subsidy. As a result, the choice proposals usually reflect the presumed savings from the diverted students spread over all the private enrollment. This, and proponents' guesses of what might be feasible to enact, lead to per student subsidy numbers like the $900 in Pennsylvania's legislation.

Education and voter turnout statistics consistently show states like Minnesota, Montana, and North Dakota highest and Southern states lowest. The strongest statistical explanation has nothing to do with school spending or educational quality measures. It is ***latitude***, the farther North the better. This conclusion is a reminder of how little is known about what determines education success. Senator Moynihan repackaged latitude as the distance of state capitols from the Canadian border and displayed the impressive statistical results in an article reprinted in State Legislatures (April).

Choice plans that provide state support to students opting for private schools have provoked massive debate in education circles, but much less debate in the legislatures. There, and in recommendations of state blue ribbon task forces, **most of the action has centered on student choices confined to public education, among schools within a district and sometimes among districts.**

Choice And The Law

Powerful and well-financed interests will litigate every aspect of choice issues, which raise important questions including separation of church and state, desegregation, the education of the nation's children, and the jobs and pay of millions of school employees. The underlying issues affect other public services which involve equally large interests, including higher education and the immense industry of providing state-funded services like day care, home health care, and nursing homes. Therefore, **all statements about the law affecting choice (including those below) are controversial and subject to litigation.**

Under a purchasing rationale, states can clearly buy services in open markets regardless of religious and other characteristics of the sellers. So rugs in state office buildings can be purchased from monks, the Salvation Army, the Mafia, and wholly owned subsidiaries of the Nazi party or Black Muslims with impunity by purchasing systems that consider only the rug and not the supplier. This doctrine extends to purchase of slots in day care systems, bed-days of nursing home care, and student-years of higher education, if the purchase is clearly of the service, rather than any kind of subsidy to the supplier.

Under a tax rationale, states can subsidize through deductions and credits activities that they could not subsidize directly. One such purpose is the furthering of religious teachings and the operation of churches and synagogues. So donations to religious groups are deductible in most income tax systems and property used for both religious and secular purposes, including religious schools, can be exempted while other property is taxed. This is the rationale behind the Minnesota tuition deduction plan that was upheld by the U.S. Supreme Court in 1983. The latest litigation has been over Iowa's 1987 copy of that plan which provides a deduction of up to $1,000 per child for expenses of private school tuition and books. A federal district court sustained the plan in March, with appeals likely.

States may not subsidize religion. States may not discriminate on the basis of race and a host of other criteria. Most of the potential choice litigation arises because one of these national principles is said to conflict with the tax and purchasing rationales. Language in state constitutions on education (e.g., free public schools) and on rights of citizens provide an independent basis for litigation in individual states. The willingness of some state courts to interpret language in state constitutions differently from the U.S. Supreme Court's interpretation of identical or substantially similar language in the federal constitution also provides a fertile basis for litigation.

Choice Survives Wisconsin Court Review

The country has been watching Wisconsin for a signal. Now they've got it.

This was Governor Thompson's reaction to the recent state supreme court decision approving Wisconsin's voucher experiment. It provides state aid of $2,500 for each of about 550 inner city youth now attending private schools in Milwaukee. It is touted by choice proponents because it might presage an alliance between inner-city parents seeking better education and state officials, who find the price right, against public school administrators and teachers. It is one of the few examples of choice programs in operation that permit private schools as an option.

The main issue in the case wasn't the validity of choice but the method of enactment. A lower Wisconsin court had held the measure invalid because it was passed as part of the state's appropriations legislation. The applicable doctrine is that "private or local interest" legislation must be passed separately. The legislature complied with this provision by defining a class of cities that included only Milwaukee. Although treated by the national media as a legal victory for the choice concept, the majority in the 4-3 decision stated in its opinion "we pass no judgment on the wisdom or desirability" of the plan. However, the opinion ran for 40 pages, lauding the plan as proof that it wasn't special interest legislation.

Because the decision interprets the state constitution, there is no grounds for appeal to the U.S. Supreme Court. Collateral attacks in federal courts on other grounds are possible. The litigants, teachers and school administrators, have much at stake.

Choice Measures In Pennsylvania

Despite the bill's initial defeat, observers say, the Pennsylvania experience is illustrative of the bitter battles that may lie ahead for many states as advocates push school choice to new fronts.

This Education Week (1/8) assessment was one of many suggesting the December choice debate in the Pennsylvania legislature was different than choice debates elsewhere. The Philadelphia Inquirer (12/12) and the New York Times (12/13) both used the phrase "intense lobbying" to describe the action.

The debate drew intensive involvement from Catholic leaders, who have been restrained in their support in other states. As in other states, public educators perceived the measure as threatening their livelihood and responded with vigor proportionate to this assessment. The measure to provide support of students in private schools passed the Senate by a narrow margin. It was rejected in the House by a vote of 114 to 89 with sizable numbers of Republicans and Democrats on each side. The issue is likely to reappear.

More Debates On Choice Likely

Choice issues are being debated in many states, with targets of the November election in California and the 1993 legislative sessions in other states. Legislation cleared a committee vote in the Illinois legislature to provide Chicago children scholarships of over $2,000 each to attend private schools. Given the state's fiscal circumstances, the measure's consideration this year is probably more of a protest against perceived high costs and low quality in Chicago public schools than a proposal likely to be enacted.

Supporters of the California initiative claim they have enough signatures to make the November ballot. It would provide vouchers of $2,500 a year that could be used to pay private school tuition. Current private school students wouldn't become eligible until 1995, two years after other students. Proponents have already spent over half a million dollars on their campaign, while opponents have expended about $200,000 to fight it by such methods as dispatching "truth squads" to sites where proponents were seeking signatures.

Arizona has a new blue-ribbon committee report on improving schools. It endorses choice, but not for private alternatives to public schools. Presaging next year's debate, the report is being criticized as recommending too much and recommending too little.

MISCELLANY

Ranking Legislators

Legislators are ranked casually with comments from lobbyists, reporters, and other legislators like, "so-and-so is the worst legislator I have ever encountered" or "one of the best freshmen members." A fancier, but no more valid, ranking occurs when small percentages of a group of observers, such as national reporters covering Congress, make such observations. Precise rankings are commonly issued by interest groups based on verifiable actions, such as how Members voted on issues. These rankings don't purport to measure effectiveness of legislators, just whether they supported the right side.

Most attempt at reputational rankings of state legislators don't deserve much credibility because of three problems: (1) no precise definition of who is being polled, (2) a low response rate among those polled because legislators and lobbyists don't want to risk getting caught making statements suggesting people they work with are ineffective, or (3) definitions of effectiveness that equate effectiveness with helping to enact an interest group's agenda. Over the years, **Reports** has seen many of these, such as a recent one in California, that fail one or another of these texts. The exception is the rankings that have been done since 1978 by the North Carolina Center. This year's version drew an 82% response from legislators themselves.

The results confirm the adage, "where you stand depends on where you sit." In the 1989-1990 session, House Republicans and some Democrats selected a new speaker. He got the second highest ranking, but the top ranking went to a co-chair of the appropriations committee. In the current session, Democrats hung together to elect the speaker. His star rose to first from sixth, the fiscal chair dropped to second, fellow Blacks rose with the speaker, and the top Republican fell from fourth to 14th. Turnover in the legislature will be higher than usual, but the reasons appear to be redistricting and quests for higher offices rather than disillusionment with legislative service found in some other states.

Virginia Follow-Up

Issue 8 featured concessions states are making to lure development and a discussion, featuring Maine and Virginia, about how frustrating the 1992 legislative sessions have been. Subsequent developments in Virginia confirm both themes. In its mid-April veto session, supporters of a transportation bond issue with a two-cent gas tax went for all or nothing rather than accept the governor's changes that would have put a smaller bond issue and no tax increase on the ballot. They got nothing. The governor supported legislation, that passed easily, to ban credit card late fees. In April he announced he was vetoing the provision. Household International announced simultaneously that it was beginning work on a Virginia facility for credit-card processing. The governor said his decision "demonstrates Virginia's willingness and ability to provide a good business environment for banks and other financial institutions while still protecting the rights of consumers." A consumer group said the decision would cost Virginians $33 million a year.

Welfare Reform Update

> *The Wisconsin plan replaces some of the old assumptions of the welfare state and recognizes the importance of personal responsibility, self-respect, independence and self-sufficiency... We must balance America's generous heart with our responsibility to the taxpayers.*

These were the President's comments on his recent approval of Wisconsin's welfare reform plan. He didn't endorse the plan but, as he has done before, lauded "innovation by the states" and supported flexibility in the federal outlook on waivers of federal rules requested by the states (see Issues 3 & 5 for examples and analysis). Wisconsin's plan has elements allowing recipients to keep more of the money they earn as well as its well-publicized cut in the benefit increase awarded when a welfare recipient has another child.

A new study of California's GAIN program shows that the effort to move welfare recipients to employment was successful, in the sense that participants improved their earnings more than members of a control group. However, the savings in welfare payments weren't dramatic. GAIN was one of the state precursors of the programs now required in all states by the federal welfare reform legislation passed in 1988.

TECHNICAL NOTES

Fiscal Policy: NCSL's report is State And Local Tax Levels: Fiscal Year 1991. In this annual report, NCSL provides rankings of state and local tax burdens that are a year more recent than those from the Census Bureau. To do this, NCSL assumes that local taxes in each state were the same percentage of personal income in FY 1991 as in FY 1990. The rankings of states by taxes in relation to income tend to be stable, particularly in years, like FY 1991, affected by few changes in state taxes. This stability is exaggerated by assuming that the local tax levels, 40% of the total, are constant. So users will get about the same result whether using FY 1990 numbers or FY 1991 numbers. The state comparisons are reprinted in other NCSL publications, State Legislatures (March) and The Fiscal Letter (March/April).

California's Woes: The Sacramento Center of the University of Southern California's School of Public Administration (1201 J St., Sacramento, CA 95814) publishes an annual book, California Policy Choices, with many insights into California's problems and policy choices. The 1991 edition includes chapters on state finances, the political process, school finance, health care, agriculture, earthquake insurance, and seaports. **Reports** resisted the temptation to draw global inferences about California problems from the recent Los Angeles riots. Property- and life-destroying riots obviously aren't a plus for economic development nor a tribute to the administration of the city or state, but it is hard to assert that such situations couldn't or won't arise in other states.

Changing Economic Fortunes: The Department of Commerce released personal income statistics on 4/22, using the fixed-weighted price index for the 4.1% inflation comparison.

Who Votes: The Census estimates of voting age population and turnout appear in Projections Of The Voting Age Population For States. Census issued its estimates of 1991 population by age for states in a press release (4/16). Use of females in the state table exaggerates population aging somewhat.

Education Reform: The National Education Goals Report (1991) and other materials on the national goals are available from the U. S. Department of Education or NGA. The quoted study of reform is from the Consortium for Policy Research in Education (c/o Eagleton Institute, Rutgers U., 90 Clifton Ave., New Brunswick, NJ 08901), Education Reform From 1983 To 1990 (12/92).

The Census Bureau (11/14/91 release) provides 1989 data on the percentage of residents who are high school graduates. SAT scores aren't directly comparable because differing percentages of students take the test. States In Profile combines rankings from SAT and ACT tests. Another approach, used in the table, adjusts the SAT ratings (see USA Today, 9/24/91). The math scores come from the National Assessment of Educational Progress, with an adjustment to ranks among 50 states rather 34 participating.

Miscellany: The not-for-profit NC Center for Public Policy Research (P. O. Box 430, Raleigh, NC 27602) issued its rankings in a press release (4/2). The study of California's welfare-to-work program, GAIN: Program Strategies, Participation Patterns, and First-Year Impacts In Six Counties is the product of Manpower Development Research Corp. (3 Park Ave., New York, NY 10016).

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STATE POLICY REPORTS

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June 1992 (First Of Two June Issues)

CONFLICTS IN STATE POLICY

Where Have All The Trends Gone?

In the 1980s, it was often accurate to describe state policy changes as trends. Policies of most states seemed to move in similar directions in response to similar problems. Leaders of states that were behind national trends often described their efforts as *modernization*, *coming into the 20th Century*, and *catching up*. Most of the trends had names, such as *deinstitutionalization, equalization*, and *circuit breakers*. Many were called *reform*, like education reform, tax reform, and welfare reform. Not everyone meant exactly the same thing by these terms, but similarities were more noticeable than differences.

Such trends aren't the pattern in 1992. Why? First, many of the changes are inherently expensive. Others are made expensive by the common practice of providing new money for changes and holding harmless those who lose. Tight fiscal conditions have slowed the spread of cost-increasing policies and produced retreats from past policies. Second, some of the major premises are being questioned. Third, in the midst of strong anti-incumbent sentiment, legislators have been reluctant to adopt changes and participate in the long, acrimonious legislative sessions that seem inevitably to precede them.

So far, the results cannot be called trends. Not all states are moving in the same direction. In the situations featured in this issue, there is clear contradiction between widely accepted prescriptions of what should be done and what is actually being done. State policy can be seen moving in two directions at once in: (1) increasing (and decreasing) the state role in school finance, (2) raising (and lowering) property taxes, (3) raising (and lowering) health care costs, (4) cutting (and expanding) Medicaid, and (5) avoiding both tax increases and spending cuts despite structural deficits.

Rest In Peace: Multiple Reforms In Alabama

In mid-May, omnibus reform legislation died in Alabama with the decision not to bring the House-passed measures to a vote in the Senate. The legislation began as a 33-bill package bringing the state more into conformity with changes over the past two decades in other states. It included budget reforms, tax reform, education reform, and management practices. The package was touted as *modernization* needed to make Alabama competitive with other states in its school systems, management, and tax policy. This "noble effort," as the speaker called it, appears dead, at least for 1992.

The package died of love and hate. Opponents of change and of new taxes were never interested. Reformers lost much of their zeal as provisions were successively watered down. Yet that zeal would have been required to campaign for the voter approval needed for the many constitutional changes required to implement the plan.

INCREASING AND CUTTING SCHOOL AID

A Greater State Share, The Once Attainable Goal

The goal of expanding state aid for schools was almost an article of faith in the 1980s. The advantages seemed overwhelming: (1) equalization among districts of differing fiscal capacity, (2) lower reliance on property taxes, and (3) a basis for increasing state control to implement mandates for quality including class sizes, minimum teacher salaries, and uniform testing. The goal of raising the share of school costs paid by state funds is universally accepted by education interests and nearly universally supported by campaign commitments of elected officials. In many states, it is enshrined in reports of blue ribbon task forces and even in school finance legislation.

During the 1980s, increasing the percentage of school costs covered by state aid appeared to be an attainable objective. Enrollments were stable, with the total public enrollment in FY 1988 actually smaller than FY 1982. State revenues were growing rapidly without tax increases because of steady national economic growth. If total spending growth could be constrained by the good sense of local school officials and/or property tax limits, the state share could increase without increasing the percentage of state budgets going to public schools.

Nationally, the state share of total school costs (including a stable federal component of 6-7%) did grow from 47.9% in FY 1982 to 48.9% in FY 1991. Two factors kept growth from being more rapid. First, local school officials raised per pupil spending considerably more rapidly than inflation as they took advantage of rapidly rising property values to gain proportional revenue increases without raising tax rates. From FY 1983 to FY 1990, spending per pupil rose by 7.7% per year. Second, some states were backsliders in relation to the national trend, allowing the local share to increase.

Obstacles Appearing

Several factors combined to make achievement of greater state shares of education costs more difficult. The first was the resumption of enrollment growth. In the four years from FY 1988 to FY 1992, enrollment grew by 1.8 million students, a 5% increase. The second was worsening state fiscal circumstances. Spending for double-digit increases in corrections and Medicaid put pressure on funding for education. Another subtle factor has been the way the outstanding investment performance of teacher and school employee retirement plans has played out in school funding. This performance has permitted lower employer contributions to the plans, resulting in extra money being available for noticeable operating costs, such as teacher salaries. Many states have taken advantage of this to cut their own costs (where they pay the employer contributions) or rationalize smaller increases in state aid (where districts pay the employer contributions).

State Patterns Vary

In FY 1992, according to new National Education Association estimates, there was an actual decline in the state share of local school receipts. The uneven pattern among the states appears in the table. The percentage change in state aid is shown as a share of the total. For example, the national total moved from 48.9% to 48.3%, so the entry is -0.6%.

Change In State Percentage Of Total School Operating Costs, FY 1991 FY 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Arkansas	2.8%	16	New Hampshire	0.1%	34	South Carolina	-0.9%
2	Idaho	1.8	16	Oregon	0.1	35	Mississippi	-1.0
3	Wyoming	1.7	26	Texas	0.1	35	Missouri	-1.0
4	Oklahoma	1.5	26	Utah	0.1	36	Rhode Island	-1.0
5	Hawaii	1.1	22	Alaska	0.0	38	Connecticut	-1.2
5	Wisconsin	1.1	22	Florida	0.0	39	Illinois	-1.3
7	Nebraska	0.9	22	West Virginia	0.0	40	Alabama	-1.5
8	Maryland	0.8	25	Ohio	-0.1	41	Arizona	-1.6
9	New Jersey	0.7	26	Indiana	-0.3	42	Montana	-1.7
10	Iowa	0.6	27	California	-0.4	43	Virginia	-2.3
10	Kentucky	0.6	27	Delaware	-0.4	44	Kansas	-2.6
12	Vermont	0.4	27	Georgia	-0.4	45	Maine	-2.8
13	North Carolina	0.3	37	Louisiana	-0.4	46	Nevada	-2.9
14	Pennsylvania	0.2	37	New Mexico	-0.4	47	Tennessee	-3.0
14	Washington	0.2		**United States**	**-0.6**	48	Massachusetts	-3.3
16	Colorado	0.1	32	North Dakota	-0.8	49	Minnesota	-3.5
16	Michigan	0.1	32	South Dakota	-0.8	50	New York	-3.6

The big story in the table is the significant shift toward local responsibility for school costs taking place in a single year. With the federal share a constant 6.2%, the drop in the average state share was associated with an increase of 0.6% in the local share. Nationwide, in order to achieve the actual 6.2% increase in school revenues, local effort was $1.3 billion more than would have been necessary if the states collectively had maintained their share.

There are special stories associated with almost all the states showing increases of 0.3 or more. The usual story is a large state tax increase for schools like those in **Arkansas**, **Oklahoma**, and **Nebraska**. In a few states, particularly **Hawaii** and **Idaho**, 1980s-like prosperity permitted 1980s-like school increases without state tax hikes. The stories associated with the reductions of 1% or more are generally all the same. State officials held a no-new-tax posture in the face of fiscal pressures by cutting their historical sharing of school costs. In a few cases, like **Rhode Island**, the fiscal problems were so serious that the state cut the state share and raised taxes.

State Shares Dropping Again This Year

From a survey of legislative leaders late last year, NCSL staff members predicted the higher-than-normal resistance to tax increases this year. Coupling this knowledge with the mathematics of state budgets, they predicted 1992 would be a tough year for education. NCSL's fiscal affairs director Ronald Snell wrote in The Fiscal Letter (Jan.), "the relatively small amounts that can be squeezed from income-support and optional Medicaid programs suggest that governors and legislators will have to turn to education cuts if taxes are indeed to be held down." NCSL fiscal analyst Tony Hutchison told a February school finance conference, "Larger than expected increases for social services, coupled with the downturn in the economy makes education very vulnerable in most states."

The table shows the variation in state responsibility for school costs. Most states are below 50%, although some pass this mark if federal aid is excluded. The table reflects the long-standing pattern of higher state shares in the South and the lowest ones in the Northeast and Midwest.

Percentage Of School Revenues From State Government, FY 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Hawaii	92.4%	18	Mississippi	52.5%	34	Connecticut	40.4%
2	New Mexico	75.8	19	Wyoming	52.5	35	Rhode Island	40.0
3	Washington	74.0	20	Iowa	52.0	36	Colorado	39.5
4	Kentucky	69.4	21	Florida	51.8	37	New Jersey	39.0
5	Delaware	67.6	22	Minnesota	51.6	38	Maryland	38.7
6	North Carolina	67.0	23	South Carolina	51.5	38	Nevada	38.7
7	West Virginia	66.9	24	Maine	48.3	40	New York	38.4
8	California	66.5		**United States**	**48.3**	41	Missouri	37.9
9	Alabama	65.1	25	North Dakota	47.8	42	Vermont	37.4
10	Alaska	63.6	26	Pennsylvania	46.9	43	Michigan	35.5
11	Idaho	63.5	27	Texas	44.8	44	Illinois	35.4
12	Oklahoma	62.9	28	Montana	44.5	45	Massachusetts	33.6
13	Arkansas	62.8	29	Tennessee	44.4	46	Virginia	33.2
14	Utah	57.1	30	Ohio	42.7	47	Oregon	26.8
15	Indiana	56.1	31	Wisconsin	42.0	48	Nebraska	26.7
15	Louisiana	56.1	32	Arizona	41.6	49	South Dakota	26.0
17	Georgia	52.9	33	Kansas	41.5	50	New Hampshire	7.6

It is unlikely that these shares are being maintained by actions on the FY 1993 budgets in most states for the reasons predicted by the NCSL staff members. Even scheduled increases, such as those of **Colorado** and **New Jersey**, are being scaled back. Legislators have also discovered that equalization mandates can be handled through formula changes increasing local effort and by spreading tax bases, as well as with higher state aid.

RAISING AND LOWERING PROPERTY TAXES

The reasons for reducing reliance on property taxes complement those for a higher state share of school costs. Public opinion polls consistently show property taxes to be less popular than state sales or income taxes. High local reliance on property taxes creates strong pressures for state actions to offset resulting problems: (1) cutting state revenue by circuit breakers and other ways of offsetting property tax payments against state tax liabilities, (2) eliminating taxes considered inimical to business development, particularly taxes on business inventory, machinery, and equipment, and (3) providing special equalization payments for municipalities with low property tax bases and/or extraordinary concentrations of tax-exempt property. In addition, the 1980s saw many states taking over, or increasing their share of funding for, previously local functions including general assistance, certain indigent health costs, courts, and a portion of local corrections costs.

No doubt, a majority of state legislators believe that state policy should be moving toward less reliance on property taxes. Yet, just the opposite has been happening. The trend was already apparent in the pre-recession state and local decisions affecting FY 1990. In that year, property tax revenues rose by 9.3% while overall state and local revenue rose by a lesser 7.9%. The latest estimates show a property tax revenue increase in the first quarter of 1992 of 6% over the same quarter a year earlier. That compares with an increase of 6.9% in sales tax revenues but only 4.3% in personal income taxes.

As recovery proceeds, income and sales tax receipts are likely to grow faster than property tax receipts. The income and sales receipts will reflect economic growth and state tax increases. The property tax revenues will reflect, with a lag, the slowdown in business investment and declining property values in some regions and sluggish increases in others.

But property tax growth could be fanned by new rounds of local rate increases associated with a decline in state school aid and state and federal aid for cities and counties. That state aid is under pressure from fiscal circumstances. There is also concern in some states that state aid has provided inappropriate incentives for local officials to spend too much because they are using other peoples' money. The shift has been dramatic in Boston. It got 61% of its revenue from property taxes in 1981. The percentage dropped to 35% in 1989, but has already increased to 44%.

Sometimes the conflicting approaches to property taxes are apparent in the same year in the same state. For example, this year Illinois' governor has made recommendations which will continue to shrink the percentage of school costs paid from state funds and sharply cut aid to cities and counties. Yet Illinois legislators have put a constitutional amendment on the November ballot to mandate that the state cover at least 50% of school costs, up from about 33% now, and to mandate equalization measures which the state's highest court has held the present constitution doesn't require.

RAISING AND LOWERING HEALTH COSTS

States will have an important role to play in health care reform. However, the Medicaid experience teaches us that if we want adequate basic health care coverage for all Americans, we cannot ask the states to finance it.

While state officials everywhere are talking about ways to slow the escalation of health care costs, they are adopting health care provider assessments that are adding to the costs of hospital services to customers. The changes are occurring rapidly, but so subtly that few people recognize the revolutionary changes taking place in financing indigent health care.

Those changes reflect the perspective of many different actors in health care finance, all reaching the same conclusion as U.S. Representative Henry Waxman, quoted above. They believe that the states cannot be asked to finance widespread basic health coverage. Waxman, who is the author of many Medicaid mandates, sees decisive national action as the answer. State officials are increasingly forcing an answer by refusing to use state general fund resources to fund Medicaid cost increases. As a result, many states are successfully shifting those costs to: (1) all consumers of health care through state taxes on health services, and (2) the federal government.

Tennessee As The Advance Force

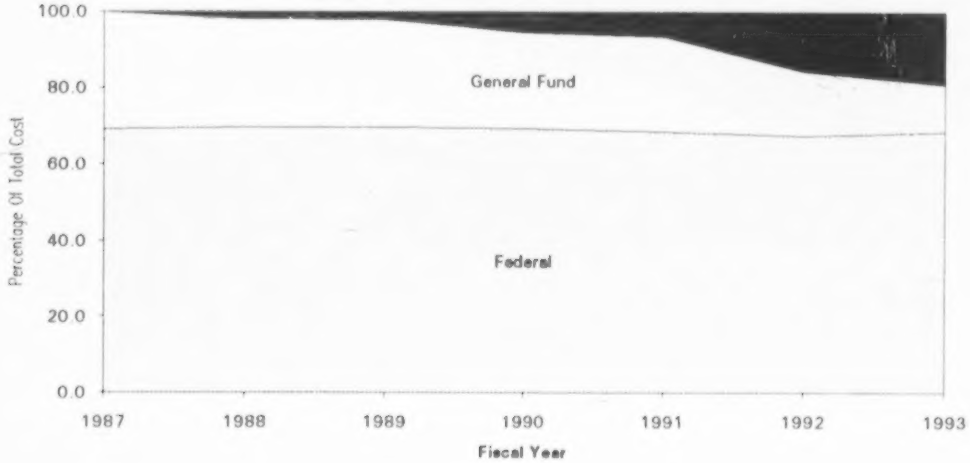
Tennessee has been a consistent pioneer in bootstrap financing -- ways to pay for Medicaid without forcing increases in state taxes. Before other states started using devices like provider donations, Tennessee was using them and standing firm in the face of opposition by federal officials seeking to avoid their budgetary impacts. Last year's federal attempt to limit Medicaid reimbursements was squarely aimed at some of the state's practices. The compromise legislation passed last year forced changes in the practices of few states, mostly just cutting off ideas that would soon be implemented. In Tennessee, it forced revision of established patterns of Medicaid finance.

This development, a sluggish economy, revenues dependent on a sales tax that doesn't respond well to the growth that does occur, and a desire to finance education reform all led the governor to push for an income tax. Tax-shy Tennessee legislators substituted a sales tax increase for the governor's income tax proposal and adopted a scaled-down version of education reform, but will probably revisit the tax issue next year.

Even the governor's tax proposal was *not* designed to increase state tax revenues for Medicaid. The new revenue would have been used for more popular objectives, lowering the sales tax and increasing education spending.

With a smaller sales tax increase, Tennessee legislators were even less inclined to allocate new general fund money to Medicaid. They didn't. Instead they worked with provider groups to devise an arrangement that *reduces* the share of Medicaid costs paid from regular tax revenues by continuing to rely upon dollars furnished by the providers, principally hospitals. The results can be seen in the patterns of Medicaid finance shown in the chart.

Reducing Reliance On Taxpayer Funding Of Tennessee Medicaid Costs



The chart shows constant federal cost sharing and consistent Tennessee success in reducing the state hard dollar share. The difference is the increasing percentage of funding supplied by health care providers. Big money is involved in the state provider assessments. The tax on hospitals will be 6.75% of gross revenues. The nursing home tax will average about $2,600 per bed-year.

The FY 1993 financing plan as presented in the chart is in violation of a federal limit on the portion of the state-funded share that can be covered by provider levies, which Tennessee officials view as limiting those levies to 48% of the state match. The solution is to package a portion of the provider assessments as broad-based taxes. Specifically, there is a new business privilege tax which applies to medical services and non-medical services such as pool halls and trailer parks. **But** other businesses get to credit their privilege tax payments against their sales tax obligations.

Variations On Provider Financing Plans

The economic effect of the new Tennessee plan is for providers to pay all of the net revenues generated by the new tax. But the legal form is different, so Tennessee will attempt to qualify its levy. Tennessee officials recognize a significant possibility that the new plan will be rejected. However, it is entirely possible that the Bush Administration will not want to reject a state Medicaid plan this fall. Arguments against rejection: (1) Rejection, which would be characterized as limiting state experimentation and causing low income people in Tennessee to lose health coverage, is the wrong thing to be doing before a Presidential election, (2) Health care generally shouldn't be addressed until 1993 and when it is addressed should be considered on a much broader basis than accepting or rejecting Medicaid plans of a few states, (3) Even if health care issues aren't to be addressed comprehensively in 1993, Medicaid issues will have to be, so action on Tennessee alone doesn't make sense.

Even if an administrative rejection is in the offing, Tennessee could seek to delay the effects of administrative action by seeking a Congressional moratorium, a strategy used in 1991, and it could litigate in the federal courts. **Even if forced back to the drawing boards by a federal rejection, Tennessee has more cards it could play.** For example, it could take credit for some tax-like devices it already uses (see Technical Notes).

Rhode Island As An Example

Like Tennessee, Rhode Island is trying to dig out of a large fiscal hole. Rhode Island's was caused by one of the nation's worst-performing economies and a state bailout of failed financial institutions. Rhode Island legislators haven't acted yet, but will probably find they have little choice other than the governor's recommendations for a collection of small tax increases and continued austerity. In FY 1993, Rhode Island may well be providing 75% less non-education aid to local governments than five years ago.

The governor's fiscal proposals have *not* included Medicaid as a beneficiary of proposed tax increases nor provided room to continue current Medicaid eligibility and services without new provider levies. While there are many locally significant disputes among and within health provider groups, they seem to recognize the choices they are being presented: (1) provider taxes combined with no curtailment of eligibility and constant or higher reimbursement rates, or (2) no provider taxes, reduced eligibility, and frozen or reduced reimbursement rates. Given these choices, which are vividly presented by the governor's budget proposals, there is a good chance that providers will elect the combination of provider taxes and higher reimbursement rates.

Other State Developments

There are developments similar to those in Rhode Island in many other states. State fiscal officials and health care providers are nervous over the provider tax proposals. However, preliminary budget discussions in nearly every state have shown strong legislative opposition to pre-election tax hikes for any purpose and even stronger opposition to tax hikes that would be justified as funding Medicaid. As providers recognize there is no alternative of continuing Medicaid without any pain, the alternative of continuing Medicaid with provider taxes looks more attractive.

There has been a revival of interest in some states in the health planning measures of the 1970s that were designed to control health care costs by requiring state approval of capital outlays. The concept is that providers will overinvest in expensive equipment and in nursing home and hospital bed capacity and then recoup the costs of excess capacity by excess utilization. Regardless of the merits of these controversial controls, the most optimistic view of savings is far less than the clear cost increases being imposed in provider taxes.

CUTTING AND EXPANDING MEDICAID

Medicaid Cuts Being Avoided

> *There is no reason the inflation rate {of health care and Medicaid costs} should be three times inflation. We need to put a tourniquet on to stop the hemorrhaging.*

These comments by Ohio's Governor Voinovich on the TV program Ohio Today in late May are typical of those of elected officials complaining about sharply escalating Medicaid costs. These concerns are in direct contradiction of the forces now playing on state officials. **Those forces strongly encourage state decisions that are raising Medicaid costs faster than would be required to cover both increasing caseloads and the inflation in health care costs.**

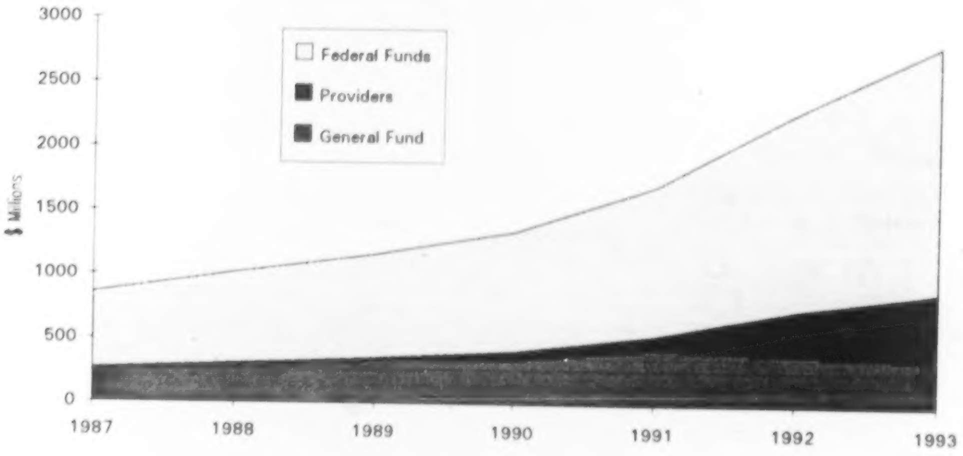
The reimbursement rate increases are frequently greater than rate increases affecting private-pay patients. This is because the rate increases are serving two purposes beyond meeting increasing costs: (1) making peace with hospitals and other providers to eliminate litigation under the Boren Amendment cases that apparently give providers standing to seek higher Medicaid reimbursements in the courts and (2) providing incentives for hospital and other provider associations to convince their members to accept provider taxes to fund Medicaid.

State Medicaid costs are also being systematically increased by decisions to shift from 100% state and private patient funding to Medicaid funding. One example is provided by Ohio, which deliberately increased its Medicaid costs, though this, of course, wasn't the objective. The objective was cutting the budget. The complex math begins with the elimination of about $140 million a year in state-funded payments to hospitals under the General Assistance medical program. The state's saving is not the hospitals' loss. They get an estimated $202 million in funding from the new "Care Assurance" program, Ohio's special title for bootstrap financing. A substantial number of patients lose their cards under the now defunct 100% state program, but get new health care cards through Medicaid.

Outcomes like these permeate decisions at many levels in most states. Another example is university hospital finance. In New Mexico, the state university hospital is getting about $28 million in private insurance payments in FY 1992, up only slightly from $27 million in FY 1987. In the same period, Medicare reimbursements grew from $13 million to $22 million, a 69% increase. The big gain was in Medicaid, rising from $11 million to $34 million, a 209% increase.

One impact of the decisions is shown in the chart below. It traces the escalation of Tennessee total Medicaid costs and the amounts being provided from the state, providers, and the federal government. It shows state costs dropping but total costs rising rapidly.

Raising Total Medicaid Costs
While Cutting State Government Costs,
Tennessee, FY 1987 To FY 1993



Medicaid Issues In Three States

Most states take the Medicaid program for granted and argue at the margins about funding sources, eligibility, services, and cost controls. More fundamental issues are being aired in **Arizona**, **Colorado**, and **Oregon.**

Avoiding Medicaid In Arizona: Health care for the poor is a major source of difficulties in the Arizona budget. It has been the only state without a Medicaid program. Instead, it has something that by its title -- the Arizona Health Care Cost Containment System -- is designed to avoid runaway costs. Decisionmakers viewed Medicaid as so inherently costly and intrusive on the state's health care system that they decided to forgo the federal cost sharing and pay for health care with 100% state and local money.

Isolation from Medicaid was expensive for Arizona and embarrassing for proponents of the federal program, so the state has been qualifying some of its activities for Medicaid. In federal FY 1991, Arizona received $139 per capita for Medicaid. The national average was $205. The AHCCCS program now (FY 1992) represents 10.5% of the budget, making it what the House Ways and Means Chairman calls the "black hole" in the budget.

One of the proposals that makes tax cuts possible in the governor's budget involves shifting substantial indigent health costs to county governments. Another approach being seriously debated is to drop the automatic coverage of certain persons in the age group 21-65, unless they meet the qualifications for federal cost sharing under Medicaid.

Eliminating Medicaid In Colorado: Dropping Medicaid entirely was debated seriously in Colorado this year. The idea sounds so appealing to frustrated legislators that NCSL recently devoted a national meeting panel to it. The idea will be considered further in Colorado based on legislation passed this session.

Colorado legislators are frustrated because many of them have signed onto two major policies: (1) a revision of the school aid formula with automatic escalation of state funding that passed several years ago and (2) no state tax increases. Last year they slid by with a scaling down of some of the promised education increases. This year the problem was worse. The outcome was austerity in other programs, limited educational increases, and a breaching of the no-new-tax policy. The governor is so dissatisfied with the result that he is pushing an initiative for the November ballot to raise the sales tax by one cent.

Medicaid Rationing In Oregon: The health care plan in Oregon limits the services available to Medicaid recipients to conform to appropriations. It has received nationwide attention as a potentially better approach that controlling costs by reducing the number of poor eligible for the program or reimbursement rates so low they require cross-subsidies from other health care customers.

After a false start in developing the priority list of services, the plan now awaits a federal decision on granting a waiver from the many Medicaid policies it violates, such as one indicating that services for the poor under Medicaid shall be comparable to those available to paying patients. The Secretary of Health and Human Services has promised a decision by the end of June.

It isn't obvious that Oregon will implement the plan even if it gets approval of the waiver. In 1993, when it considers the first major budget embodying the plan, Oregon legislators will also be seeking to deal with voter-initiated Measure 5. It seems to commit a substantial portion of the state's budget, off the top, to replacing local school property tax revenue lost to Measure 5 rollbacks. The governor has already announced that 4,000 employees will be dropped from the state's payroll in anticipation of the fiscal effects.

Assessing The Escalating Costs

State Medicaid spending numbers cannot readily be compared because of differing practices in what is included in the budget and when spending is recognized (e g., accrual v. cash). But federal reimbursement timing and concepts are the same for all states, so Medicaid spending changes can be tracked by looking at the changes in the federal match as done in the table below.

Percentage Change In Medicaid Federal Grants, FY 1990-FY1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Missouri	77.7%	18	Alabama	33.0%	34	Iowa	25.0%
2	New Hampshire	68.9	19	Pennsylvania	32.4	35	Virginia	25.0
3	Wyoming	60.7	20	Florida	31.6	36	Oklahoma	24.6
4	West Virginia	49.4	21	Kansas	30.8	37	South Dakota	24.4
5	Louisiana	47.1	22	Mississippi	29.5	38	New York	23.4
6	Delaware	45.0	23	Montana	29.3	39	Minnesota	21.4
7	Nevada	44.6	24	Idaho	29.2	40	Ohio	20.4
8	South Carolina	43.4	25	Michigan	29.1	41	North Dakota	20.1
9	Kentucky	42.9	26	Oregon	28.8	42	Wisconsin	20.0
10	Rhode Island	41.9		**United States**	**28.6**	43	Indiana	19.9
11	New Mexico	39.4	27	Connecticut	28.3	44	Arkansas	19.8
12	Texas	39.1	28	New Jersey	27.8	45	Washington	19.4
13	Maine	38.7	29	Vermont	27.7	46	Hawaii	18.1
14	Colorado	38.6	30	Arizona	27.3	47	California	17.1
15	North Carolina	37.8	31	Maryland	26.4	48	Alaska	12.6
16	Tennessee	34.7	32	Nebraska	25.1	49	Illinois	12.1
17	Massachusetts	33.9	33	Georgia	25.0	50	Utah	11.5

The table shows federal (and thus state) Medicaid cost escalation that averaged nearly 30% in FY 1991. While the federal estimates aren't in yet for FY 1992, results to date suggest that another escalation in the 25-35% range is taking place this fiscal year.

As shown on the table, only eight states experienced an increase of less than 20%, less than the number that increased spending by more than 40%. The second important aspect is the identity of the states that have felt the most fiscal pressure. States with relatively generous Medicaid programs -- including California, Hawaii, and New York -- show increases well below the national average. States with traditionally low spending on Medicaid appear near the top of the rankings. The major reason is the impact of federal mandates. They have had little effect on the more generous states, but have forced major increases in Medicaid eligibility in the states that have maintained the lowest cost programs.

Fear And Trembling

State officials are, to put it mildly, nervous about the rapid developments in Medicaid finance. The statements below are from legislators during the Tennessee House debate on Medicaid finance. The first two are from John Bragg, the House Finance Chairman who has long been active in NCSL activities. The rest are from other legislators.

> *We continue to dig a hole that is going to bury us.*
>
> *In two years, our Medicaid bill has gone up $1.1 billion. Next year, it is going up $500 million. We are living in a dream world on this Medicaid program.*
>
> *This thing is just about to eat us up. We put money in. It grows bigger, and we haven't solved anything.*
>
> *There is too much gold in this thing for too many people.*
>
> *The plan we had before was considered a ruse and a subtrafuge. We took federal dollars and matched them with federal dollars. Many other states used the same ruse.*

AVOIDING TAX INCREASES *AND* SPENDING CUTS

Legislators in many states have taken the implicit advice of press criticisms of their actions last year as too partisan, too lengthy, and too disputatious. This year they are adopting budgets with a minimum of dispute and a maximum of dispatch and getting out of town fast. Examples are **Iowa**, **Maine**, **Minnesota**, **Washington**, and **Wisconsin**.

Achieving this objective requires that policy disputes be minimized by avoiding the sharp changes in policy that tend to make for bitter disputes and long sessions. The list of what to avoid includes tax reform, large increases in general taxes, school aid formula revisions, and massive cuts in state programs. Austerity without changes in program concepts is much more acceptable. As a result, much less has been heard about major spending retrenchments this year than last year.

One group of exceptions are the states where a major tax increase has been proposed, but may not be enacted. In those states, the debate centers first on the tax increase with the retrenchments to be discussed later. **Tennessee** began its session that way along with **Maryland** and **Florida**. In both Maryland and Tennessee, legislators were presented a choice between: (1) a budget with no new taxes and sharp spending cuts and (2) a relatively generous alternative proposed by the governor. In both states, they rebelled at both alternatives and adopted more austere budgets and smaller tax increases. The issue in Florida is still in doubt.

The other group of exceptions are the states where a major political force is making a run at significant spending cuts and forcing tax cuts -- **Massachusetts**, **Michigan**, and **New Jersey**.

In **Massachusetts**, income taxes have already dropped slightly. This could make the Bay State the only one in the union to drop taxes this year as seen by **Reports** and taxpayers. {Believers in scheduled future rate reductions won't count the Massachusetts action as a tax cut and will blame New York for a massive tax increase for not implementing scheduled reductions.} Agreement has been reached on consensus tax collection estimates for FY 1993 *above* those in the governor's budget. There is still concern that non-tax revenues are overestimated and spending underestimated.

The added tax cuts recommended by the governor remain a serious possibility, though the budget being developed in the legislature doesn't include them. As described by the Boston Globe (5/16), the legislative approach is low key and incremental, avoiding controversial budget cuts and proposed tax changes.

> *But unlike the last three years, no one appears to be talking about the need for wholesale reforms in the "budget buster" accounts that dominate state spending, such as the $2.8 billion Medicaid program, $800 million Aid to Families with Dependent Children and the $400 million Massachusetts Bay Transportation Authority deficit. Likewise, in the biggest state agencies, such as the Correction, Mental Health and Mental Retardation departments and state colleges and universities, the budget debate will generally be whether to add a few million dollars here or there over current spending levels.*

Michigan's fiscal outlook has deteriorated so badly that tax cuts appear unrealistic. The governor's budget is tight, but didn't match last year's for sharp cuts, like those made in the general assistance program. Instead, his emphasis has been on cutting and capping local property taxes. Democrats in the legislature have a plan of their own. The outcome is likely to be that both parties will take a record of unsuccessfully trying to force local tax cuts to voters in November, blaming the other party for their lack of success.

In **New Jersey**, legislative Democrats are now in a minority in the aftermath of their support of the large tax increases of 1990. Their posture is recognizing the loss and challenging the new majority to make sense of state policy. As the Democratic leader in the Senate recently put it:

> *Somebody really should figure out a way to tell the Republicans that the campaign is over. This insistence on rehashing campaign cliches won't do after voters gave them a mandate to govern.*

To govern through their veto-proof legislative majorities, the Republicans need both a fiscal plan and enough cohesiveness in voting to enact it without help from the Democratic minorities and Governor Florio (D). Problems are arising on both fronts. The cornerstone of the fiscal plan is a rollback of the one-cent sales tax increase, but not the other parts of the tax increase package. With a tight budget overall, the fiscal building that went with this cornerstone needs some major building blocks including ways to defer spending increases and real spending reductions.

The governor preempted many of the spending deferrals in his budget proposal. Defense against spending reductions, particularly in support of the large property tax rebate program, has been stiff. The environment turned worse in May with announcement of major shortfalls in revenue in FY 1992 and relative to the budget levels for FY 1993. The governor's veto of the sales tax reduction has been overridden.

Two other states might see tax reductions this year, but not in circumstances where they could be cited as examples of budget cutting led by elected officials. When **Missouri** voters rejected the tax increase on the 1991 ballot, they also rejected extension of some temporary levies. Unless the governor and legislature agree on a smaller tax package not requiring voter approval, these tax rates will drop automatically. **Pennsylvania** taxes would also drop pursuant to scheduled reduction, which the governor's budget recommends take place on schedule. Even with the reduction, the massive 1991 tax increase will largely be left intact.

What happens when state officials can't conceivably adopt a new budget without the tax increases or sharp spending cuts being avoided in most states? No one knows. The test case is **California** where no solutions are appearing for the deteriorating fiscal situation.

ATTRACTING CORPORATE HEADQUARTERS

Corporate headquarters are economic development prizes. They are prestigious clean industry with high paying jobs and often are associated with supporting activities such as R&D centers. The table shows the concentration of **Fortune**'s (4/20) 500 company headquarters. They are highly concentrated in a few of the largest states, with the largest numbers in Northeastern and Midwestern industrial states. Ten states have none.

Headquarters of Fortune 500 Companies, 1991

State	Number	State	Number	State	Number	State	Number
New York	56	Massachusetts	15	North Carolina	5	Nebraska	3
Illinois	46	Virginia	13	Oregon	5	Arizona	2
California	44	Missouri	12	Washington	5	Kansas	2
Texas	39	Wisconsin	12	Arkansas	4	Kentucky	2
Ohio	34	Georgia	11	Delaware	4	New Hampshire	2
Pennsylvania	34	Indiana	11	Louisiana	4	Tennessee	2
Connecticut	28	Florida	7	Maryland	4	West Virginia	2
New Jersey	22	Colorado	6	Oklahoma	4	Idaho	1
Michigan	20	Alabama	5	Rhode Island	4	Mississippi	1
Minnesota	16	Iowa	5	South Carolina	4	Utah	1

The picture changes considerably when the number of headquarters is related to each state's population. Connecticut ranks highest because of the many corporations it has drawn to Fairfield County just outside of New York City. Eastern industrial states generally do best, while California and Southeastern states are below the national average.

Fortune 500 Corporate Headquarters Per Million Population, 1991

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Connecticut	8.5	15	Virginia	2.1	28	West Virginia	1.1
2	Delaware	5.9		**United States**	**2.0**	29	Washington	1.0
3	Illinois	4.0	16	Indiana	2.0	30	Idaho	1.0
4	Rhode Island	4.0	17	Nebraska	1.9	31	Louisiana	0.9
5	Minnesota	3.6	18	New Hampshire	1.8	32	Maryland	0.8
6	Ohio	3.1	19	Iowa	1.8	33	Kansas	0.8
7	New York	3.1	20	Colorado	1.8	34	North Carolina	0.7
8	Pennsylvania	2.8	21	Oregon	1.7	35	Utah	0.6
9	New Jersey	2.8	22	Arkansas	1.7	36	Kentucky	0.5
10	Massachusetts	2.5	23	Georgia	1.7	37	Arizona	0.5
11	Wisconsin	2.4	24	California	1.4	38	Florida	0.5
12	Missouri	2.3	25	Oklahoma	1.3	39	Tennessee	0.4
13	Texas	2.2	26	Alabama	1.2	40	Mississippi	0.4
14	Michigan	2.1	27	South Carolina	1.1		All Others	0.0

A major headquarters relocation is a rare development coup. A more common method for a state to gain headquarters is for one of its companies to displace another from the top 500 by merger or by faster growth. From 1981 to 1991, 35 states have had changes in the number of the 500 headquarters. Most of the changes are small, but the movement away from New York and toward Texas is fairly dramatic, as shown in the table.

Change In Headquarters of Fortune 500 Companies, 1981 To 1991

State	Change	State	Change	State	Change	State	Change
Texas	13	Arkansas	2	New Jersey	1	Maryland	-2
Virginia	9	Louisiana	2	Utah	1	North Carolina	-2
Georgia	5	Nebraska	2	Kansas	-1	Tennessee	-2
Indiana	4	Washington	2	Kentucky	-1	Wisconsin	-2
Iowa	4	West Virginia	2	Michigan	-1	Connecticut	-4
Alabama	3	Colorado	1	Missouri	-1	Pennsylvania	-5
California	3	Delaware	1	Ohio	-1	Illinois	-7
Florida	3	Minnesota	1	Oklahoma	-1	New York	-33
Rhode Island	3	Mississippi	1	Oregon	-1		

As critics of "smokestack chasing" point out, Fortune 500 companies aren't major sources of net job growth. More rapid growth (and decline) is found among smaller companies. Capturing statistics on this growth isn't easy because much of the activity measured in standard statistics, such as business incorporations and failures, reflects the ebb and flow of competitors in local markets for restaurants and specialty retailers. One of many useful indicators is the Inc. Magazine (Dec.) version of the top 500, identifying the fastest-growing private companies. The location of these companies is much more likely to be in the South and West than the Fortune 500 companies.

Headquarters of Inc 500 Fastest Growing Private Companies, 1991

State	Number	State	Number	State	Number	State	Number
California	84	Arizona	12	Missouri	6	Mississippi	2
Texas	40	Indiana	12	New Mexico	5	Wyoming	1
Virginia	27	Colorado	11	Kansas	5	Vermont	1
Florida	25	Washington	11	Connecticut	5	Alaska	1
Massachusetts	22	Ohio	11	Tennessee	5	North Dakota	1
Pennsylvania	19	Georgia	9	New Hampshire	4	South Dakota	1
New York	19	Utah	8	Nevada	4	Rhode Island	1
Illinois	18	North Carolina	8	Nebraska	4	West Virginia	1
Michigan	17	Oregon	7	Delaware	3	Arkansas	1
Wisconsin	14	Kentucky	7	Idaho	3	Hawaii	0
New Jersey	14	Oklahoma	6	Iowa	3	Maine	0
Minnesota	13	Alabama	6	South Carolina	3	Montana	0
Maryland	13	Louisiana	6				

Relating state success in attracting and "growing" these companies to population, as shown in the table, presents a much different picture from that shown for the Fortune 500 companies.

Inc. 500 Corporate Headquarters Per Million Population, 1991

Rank	State	Number	Rank	State	Number	Rank	State	Number
1	Utah	4.5	18	Washington	2.2	34	South Dakota	1.4
2	Delaware	4.4	19	Wyoming	2.2	35	Louisiana	1.4
3	Virginia	4.3	20	Indiana	2.1	36	Georgia	1.4
4	Massachusetts	3.7		**United States**	**2.0**	37	North Carolina	1.2
5	New Hampshire	3.6	21	Kansas	2.0	38	Missouri	1.2
6	Colorado	3.3	22	Oklahoma	1.9	39	Iowa	1.1
7	New Mexico	3.2	23	Kentucky	1.9	40	New York	1.1
8	Arizona	3.2	24	Florida	1.9	41	Tennessee	1.0
9	Nevada	3.1	25	Michigan	1.8	42	Ohio	1.0
10	Minnesota	2.9	26	New Jersey	1.8	43	Rhode Island	1.0
11	Idaho	2.9	27	Vermont	1.8	44	South Carolina	0.8
12	Wisconsin	2.8	28	Alaska	1.8	45	Mississippi	0.8
13	California	2.8	29	Pennsylvania	1.6	46	West Virginia	0.6
14	Maryland	2.7	30	North Dakota	1.6	47	Arkansas	0.4
15	Nebraska	2.5	31	Illinois	1.6	48	Hawaii	0
16	Oregon	2.4	32	Connecticut	1.5	49	Maine	0
17	Texas	2.3	33	Alabama	1.5	50	Montana	0

THE 1992 DEVELOPMENT REPORT CARD

The Report As A Sandwich: The CfED "report card" on state economic development is now in its sixth year. It is best understood as a sandwich. The meat in the 191-page report gets better every year. The report is a research source with solid, documented, and analytically useful statistics built on the same economic concepts that underlie state economic development policies. The relishes packaged with the meat in appendices are useful statistical approaches to three common state concerns: (1) the extent to which an economy is built upon strength in selling nationally and internationally traded goods and services, (2) the vulnerably of state economies to national economic changes, and (3) disparities between rural and urban areas in each state.

The bread is the ranking system itself, the press materials, and a short essay stressing six "lessons." These lessons aren't drawn from the data and are unlikely to commend themselves as useful to those who find the rest of the report useful. But the bread can be stripped and the meat savored for its quantity and quality.

Winners And Losers: Like a report card, the report doesn't provide one overall grade. Instead there are various subindexes that lead to three main grades which, for most states, are closely correlated: (1) economic performance, (2) business vitality, and (3) development capacity. The top and bottom states are shown in the table. Grade-point averages (A=3, F=-1) were supplied by **Reports**. There is no composite ranking in the report.

Grades In 1992 Development Report Card, Selected States

State	Performance	Vitality	Capacity	Average	Rank, PCI
Top-Ranked States					
Delaware	A	A	B	2.7	39
Maryland	A	B	A	2.7	40
Minnesota	B	A	A	2.7	28
Utah	A	B	A	2.7	9
Connecticut	A	B	B	2.3	44
California	C	A	A	2.3	45
Colorado	C	A	A	2.3	22
Selected Other States					
New York	C	C	A	1.6	29
Texas	D	A	B	1.6	17
Massachusetts	C	D	A	1.3	48
Pennsylvania	B	C	C	1.3	24
New Hampshire	B	D	C	1.0	50
Bottom-Ranked States					
Florida	C	C	D	0.6	38
Alabama	D	C	D	0.3	10
North Dakota	D	C	F	0.0	1
Arkansas	F	C	F	-0.3	12
West Virginia	D	D	F	-0.3	11
Mississippi	F	D	F	-0.6	14
Louisiana	F	F	F	-1.0	6

Getting a poor grade from CfED may indicate development success as voters and elected officials would measure it. The last column on the table shows state ranks in per capita income growth from 1988 to 1991 as shown in Issue 10. All six CfED bottom states placed in the top 15 by that measure. This suggests a poor CfED grade is associated with strong personal income growth.

All the bottom CfED states were in the top 30 in **Reports**' Index of State Economic Momentum (Issue 6). The average ranking of CfED's bottom-ranked states in the Index's job growth component was 16.3. Its top ranked states' average job-gain rank was a lower 28.6. So a poor report card is associated with strong job growth.

While it isn't a good predictor of development success of states, **the Report Card is probably a success given its objectives.** Before it was started, the Grant Thornton "business climate" rating was the only comparative statistic in town. Its focus is on minimizing cost for manufacturers. As a result, the Southeastern states rank high because of low wages, low taxes on manufacturing, and less generous programs for unemployment compensation and Workers' Compensation than Northeastern states. By using high wages as a plus rather than a minus and giving low grades for Southeastern problems like low educational attainment and high infant mortality, the Report Card reverses these results. The result is a standoff for those who like to debate state policies in terms of simple indices.

There is a wealth of data in the detailed report. There is no substitute for looking through the tables. For example, there one discovers that Mississippi and Louisiana are ranked first and second in manufacturing capital investment. The success of targeted development policy shows in commercial bank deposits per capita where Delaware and South Dakota lead by wide margins. Venture capital investments are greatest in Massachusetts, Rhode Island, and California.

THE HIGH STAKES IN CHICAGO CASINOS

> *The moral question is ended. We have a lottery. You can walk out of your home and go to a local grocery -- instead of buying some milk, buy a lottery ticket. You can go to off-track betting on State Street. You can float from Joliet going south, you can float all over the State of Illinois in gambling casinos.* -- Chicago Mayor Daley (4/2) announcing support for casino gambling.

The Illinois casino proposal has substantial implications for approval of gambling and finances in other states. Nevada and Atlantic City (NJ) still have an effective monopoly on destination-resort casinos within the U.S. Riverboat gambling on the Mississippi, gambling on Indian reservations, Deadwood (SD) and proposed extensions in many states, video poker, and charity casino nights all offer increasingly stiff competition, but none of these will draw large conventions. The Chicago plan would. It has backers with enough money to drop $2 billion on new facilities. Caesars World, Circus Circus, and Hilton Hotels are lined up and Hyatt Hotels is considering the $500 million ante.

Approval would have uncertain effects on casino proposals elsewhere, such as Cleveland and Detroit. On the one hand, it would tend to break the ice for other proposals much as lotteries became increasingly acceptable in reluctant states as other states approved them. The issue became not whether residents would gamble but whether they would spend their money in-state or elsewhere. On the other hand, a casino complex in Chicago would eat into potential markets for ones in Detroit, Cleveland, or other major cities.

Other Illinois gambling activities would probably suffer from casino approval, although there is plenty of room for dispute about which activities and how much. According to industry representatives and Governor Edgar, the horse racing industry, which has fallen on hard times for other reasons, would suffer. So would the nascent riverboat gambling industry, which is about to open two boats in Joliet, close to Chicago. More speculative is the effect on charity gambling and state lotteries.

FEDERAL GRANTS TO STATES

Federal grants to state and local governments are continuing to grow much faster than revenues those governments are raising from their own taxpayers. Grants in the first quarter of 1992 were up 17% from the same quarter a year earlier. The major reason is Medicaid. The latest state-by-state data are shown in the table below.

Percent Increase In Federal Grants To State And Local Governments, FY 1990-FY 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Missouri	29.9%	18	Ohio	15.4%	34	Arizona	11.7%
2	West Virginia	27.3	19	Tennessee	15.2	35	Alabama	11.7
3	New Hampshire	26.5	20	Arkansas	15.1	36	Nebraska	11.4
4	Hawaii	23.6	21	Iowa	14.4	37	Wisconsin	10.3
5	Delaware	23.3	22	Mississippi	14.2	38	Washington	10.3
6	Nevada	23.1	23	Michigan	14.2	39	South Carolina	9.8
7	Louisiana	22.2	24	Indiana	14.2	40	New York	9.3
8	Massachusetts	22.1	25	Kansas	14.1	41	Maryland	8.8
9	Kentucky	22.0		**United States**	**14.1**	42	Virginia	8.7
10	Maine	21.5	26	Oklahoma	14.0	43	Vermont	8.5
11	Connecticut	21.3	27	Florida	13.8	44	Minnesota	8.2
12	California	21.2	28	Texas	13.8	45	South Dakota	5.5
13	Colorado	19.5	29	New Jersey	13.6	46	Wyoming	5.1
14	Rhode Island	17.5	30	Georgia	13.3	47	Idaho	3.7
15	North Carolina	17.2	31	North Dakota	13.2	48	Alaska	2.9
16	New Mexico	16.6	32	Illinois	12.8	49	Utah	0.1
17	Montana	16.2	33	Pennsylvania	12.2	50	Oregon	-0.8

For the past several years, federal grant policy has been more stable than in decades. The budget control legislation created an environment discouraging major expansion of most federal programs. Most programs have also avoided deep cuts. Stable funding has discouraged major changes in the factors used to allocate grants among states. The big money changes have been in AFDC and particularly Medicaid, where continuing current services has led to sharp increases in spending.

The percentage increases have been largest in states with low per capita federal aid and smallest in states -- like New York and Vermont -- that have relatively generous social programs and thus higher per capita federal matching funds. The prime reason for the differential growth is that mandates -- for example, covering intact families with AFDC and expanding Medicaid -- have the most impact on the states with the least generous programs.

The state rankings in per capita federal grants show large disparities in federal support of state and local programs. Alaska and Wyoming get more than twice the national average. Florida and Virginia get less than two-thirds of the average.

Per Capita Federal Grants To State and Local Government, FY 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Wyoming	$1,299	18	Tennessee	$632	34	Missouri	$548
2	Alaska	1294	19	Arkansas	607	35	Nebraska	545
3	New York	954		**United States**	**599**	36	Georgia	536
4	Rhode Island	904	20	South Carolina	584	37	Iowa	528
5	Montana	850	21	New Jersey	582	38	Maryland	526
6	North Dakota	840	22	Oregon	580	39	Illinois	516
7	Massachusetts	785	23	Michigan	579	40	North Carolina	512
8	South Dakota	767	24	Minnesota	577	41	Colorado	506
9	Louisiana	764	25	Alabama	574	42	Indiana	493
10	Maine	749	26	Pennsylvania	574	43	New Hampshire	488
11	Connecticut	727	27	Ohio	569	44	Arizona	483
12	New Mexico	722	28	Delaware	568	45	Utah	474
13	Vermont	721	29	Idaho	568	46	Kansas	467
14	West Virginia	713	30	Wisconsin	565	47	Texas	452
15	Mississippi	703	31	Washington	564	48	Nevada	423
16	Kentucky	672	32	Oklahoma	563	49	Florida	392
17	Hawaii	651	33	California	556	50	Virginia	387

The formula for being high on this list *without* spending extra state money is to be (1) a resource-rich state with large federal landholdings resulting in shared revenues from exploitation of minerals, grazing areas, oil and gas, and timber, (2) a state with many federal installations and/or Indian reservations giving rise to impact aid for schools and other special payments, and/or (3) a less populous state benefiting from the per-state minimums in some federal programs. Having a large poor population and low fiscal capacity helps, but not enough to pull Southeastern states from the middle of the rankings. Federal grants for AFDC and Medicaid and some smaller programs respond to state decisions on eligibility and payment rates as well as state aggressiveness in qualifying spending for reimbursement. These factors account for the high rankings of New York, Rhode Island, and Massachusetts. States without substantial public lands and generous social programs are on the bottom of the rankings.

TECHNICAL NOTES

Property Tax Reliance: The growth of property tax reliance through FY 1990 can be calculated by state from Census data. The estimate for the first quarter of 1992 isn't broken down by state by its originator, the Bureau of Economic Analysis of the Commerce Department.

Health And Medicaid Costs: The Medicaid cost increase table should match increases in state cash outlays during the period of October 1990 to October 1991 because the federal match is a constant ratio to the state outlays. The increases will be close to FY 1991 state increases, but not the same because most state fiscal years are three months different from the federal one used in the table and there are slight changes in matching ratios affecting the lower per capita income states.

The quote from Representative Waxman is from his article in a symposium on intergovernmental health care issues in Intergovernmental Perspective (Spring). The quotes from the Tennessee debate are from the Tennessean (5/3), which also printed the Medicaid fiscal statistics from the Tennessee Medicaid Bureau that form the basis for the two charts on Tennessee Medicaid finance.

Many states force subsidy of provision of services to low income persons, parallel to Medicaid for health care, by methods not involving general fund taxes. This is done in rate orders for telephone, electric, and gas service through "lifeline rates." It is done in assigned risk plans in auto insurance, health insurance, and in a variety of regulatory attempts to get financial institutions to make investments in distressed areas. There are also levies on providers of services to fund indigent criminal defense, losses from breaches of trust by lawyers and other fiduciaries, and more. Considerable effort has gone into design of these plans so they do not appear to involve a *tax* or a *subsidy*. Tennessee's next shot at qualifying health provider levies is to reverse these presumptions by converting them into explicit taxes and subsidies parallel to explicit taxes and subsidies in Medicaid.

Packaged as part of an overall state policy for the indigent (e.g., telephone subsidies in telephone rates, indigent defense in lawyers' charges, hospital care for the indigent in hospital charges), it would be hard for federal officials to reject a new Tennessee plan. While it would take credit for what the state is already doing, it is not a subterfuge.

Measuring Development: The 1992 Development Report Card is published by the Corporation For Enterprise Development (777 North Capitol St., Washington, DC 20002). The persistent inability of either CfED or Grant Thornton to produce rankings that correlate closely with recent developmental successes won't surprise believers in the theory that business moves to places with low incomes and workers moves away from them will tend to equalize per capita incomes. See "Are Regional Per Capita Earnings Diverging?" in the Business Review (Federal Reserve Bank of Philadelphia, March/April).

Federal Grants: Federal grant spending is reported in the Census Bureau publication Federal Expenditures By State For Fiscal Year 1991.

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STATE POLICY REPORTS

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June 1992 (Second Of Two June Issues)

THE INDEX OF STATE ECONOMIC MOMENTUM

Major Differences In State Economic Performance

The latest Index of State Economic Momentum shows continued uneven growth in state economies.

Index Of State Economic Momentum, June 1992

Rank	State	Index	Rank	State	Index	Rank	State	Index
1	Nevada	3.36%	18	Wisconsin	0.89%	34	West Virginia	-0.12%
2	Idaho	2.05	19	Alabama	0.77	35	Maine	-0.15
3	Washington	1.98	20	Tennessee	0.77	36	Nebraska	-0.17
4	Utah	1.84	21	Georgia	0.61	37	South Carolina	-0.17
5	Arkansas	1.64	22	Minnesota	0.61	38	Missouri	-0.22
6	Montana	1.49	23	North Dakota	0.51	39	California	-0.39
7	North Carolina	1.47	24	Indiana	0.50	40	Ohio	-0.48
8	Oregon	1.38	25	Louisiana	0.50	41	Oklahoma	-0.50
9	Hawaii	1.33	26	Arizona	0.49	42	Pennsylvania	-0.54
10	Colorado	1.19	27	Florida	0.48	43	Illinois	-0.61
11	Alaska	1.17	28	Kansas	0.45	44	Maryland	-0.86
12	Texas	1.17	29	Vermont	0.33	45	New Hampshire	-1.14
13	Kentucky	1.15	30	Iowa	0.09	46	Massachusetts	-1.16
14	South Dakota	1.13	31	Michigan	0.04	47	New Jersey	-1.20
15	Mississippi	1.09	32	Delaware	0.00	48	Rhode Island	-1.47
16	New Mexico	1.05		**United States**	**0.00**	49	New York	-1.49
17	Wyoming	1.02	33	Virginia	-0.08	50	Connecticut	-1.62

Western states dominate the top ranks of the states in this composite measure of economic performance. **Nevada** keeps its top ranking despite some economic slowing, primarily because of its strength in drawing retirees who create new jobs in housing construction, government, and service industries. Other top-ranked states have been outperforming the nation in job growth and thus in personal income growth and, sooner or later, in population growth.

The Index sets the national average at 0%, which reflects personal income growth of 2.8%, employment loss of 0.4% and a population gain of about 0.8%. A state matches this average by matching all three components, or by any combination of deviations from them that cancel each other. Most regions are represented among the average-performing states. They include previous high flyers like **Florida** as well as **Iowa**, **Delaware**, **Michigan**, and **Vermont**. Because the most populous states are showing below average performance, more than half the states are beating the national average.

Northeastern states dominate the bottom ranks as they have for the last several quarters. Important changes are taking place among the bottom ranks. First, **California** is sinking. It fell from 25th in December (Issue 24 of 1991) to 37th in March (Issue 6) to 39th in the current index. Second, most of the New England states are improving their performance relative to other states. In the last index, the bottom five ranks were all held by New England states, but now **New Jersey** (#47) and **New York** (#49) have moved into the bottom five. Third, the New England states are moving closer to the national average. For example, **Massachusetts** has moved from -2.4% in the last index to -1.2% in this one.

Employment Shows Slight Decline

From March of last year to this March, the nation's economy lost about 400,000 jobs, or about 0.37% of all jobs. The distribution of job gains and losses was highly skewed, with 32 states experiencing gains and 18 showing losses. **Texas** was the largest gainer (74,200) followed by **Indiana** (33,200), **Washington** (31,600), **North Carolina** (28,500), **Kentucky** (26,600), and **Arkansas** (25,200).

As has been the case for the past several quarters, the job gains are concentrated in states West of the Mississippi River. Of the top 17 states, only **Kentucky** and **Indiana** are East of that river. Of the bottom 17 states, only **California** and **Oklahoma** are West of the Mississippi.

Percentage Change In Employment, March 1991 To March 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Idaho	3.7%	18	Louisiana	1.3%	34	Virginia	-0.5%
2	Arkansas	2.7	19	Minnesota	1.1	35	Vermont	-0.6
3	Nevada	2.7	20	Texas	1.0	36	Florida	-0.6
4	South Dakota	2.6	21	Tennessee	1.0	37	Oklahoma	-0.7
5	Montana	2.5	22	Iowa	1.0	38	Illinois	-0.7
6	North Dakota	2.4	23	North Carolina	0.9	39	Ohio	-1.1
7	Utah	2.3	24	Wisconsin	0.9	40	Pennsylvania	-1.3
8	Kansas	2.3	25	New Mexico	0.8	41	South Carolina	-1.3
9	Kentucky	1.8	26	Alabama	0.7	42	California	-1.4
10	Alaska	1.8	27	West Virginia	0.3	43	New Hampshire	-1.7
11	Mississippi	1.6	28	Maine	0.3	44	Rhode Island	-1.7
12	Colorado	1.5	29	Arizona	0.2	45	Massachusetts	-1.9
13	Washington	1.5	30	Michigan	0.2	46	Delaware	-1.9
14	Wyoming	1.4	31	Georgia	0.1	47	Maryland	-2.5
15	Indiana	1.3	32	Nebraska	0.0	48	New Jersey	-2.6
16	Hawaii	1.3		**United States**	**-0.4**	49	New York	-2.7
17	Oregon	1.3	33	Missouri	-0.5	50	Connecticut	-3.0

Job losses were concentrated in **New York** (-214,400) and **California** (-179,900). These two states can be viewed as absorbing the total national job loss, with the other 48 states reflecting no net change in jobs. Of the other 48, the large job-losing states were **New Jersey** (-92,100), **Pennsylvania** (-63,800), **Massachusetts** (-53,100), **Ohio** (-52,700), and **Maryland** (-52,400). While New York and California lost the most jobs, they didn't have the worst percentage loss, an honor won by **Connecticut**.

Personal Income Growth Slow

Personal income in the fourth quarter of 1991 was 2.8% ahead of personal income one year earlier. This increase is exactly equal to the change in the Consumer Price Index between February of this year and a year earlier. So, adjusted for inflation, personal income didn't show any growth. The state-by-state statistics are shown in the table.

Percentage Change In Personal Income, Fourth Quarter 1990 To 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	North Carolina	5.7%	17	Oregon	4.2%	32	Pennsylvania	2.7%
1	Wyoming	5.7	17	Wisconsin	4.2	35	Missouri	2.6
3	Utah	5.4	20	South Dakota	4.1	36	Nebraska	2.5
4	Montana	5.3	21	Tennessee	4.0	36	Oklahoma	2.5
5	Arkansas	5.2	22	Delaware	3.9	38	Virginia	2.4
6	Washington	5.1	23	Georgia	3.9	39	Iowa	2.3
7	Mississippi	4.9	23	Vermont	3.9	40	New Jersey	2.2
7	Nevada	4.9	25	North Dakota	3.4	41	Kansas	2.1
9	New Mexico	4.8	26	Arizona	3.3	42	Maryland	2.0
10	Colorado	4.7	26	West Virginia	3.3	43	Illinois	1.9
10	Hawaii	4.7	28	Minnesota	3.1	44	Maine	1.8
12	Alabama	4.6	28	South Carolina	3.1	45	California	1.6
12	Kentucky	4.6	30	Indiana	3.0	45	Massachusetts	1.6
12	Texas	4.6	31	Florida	2.9	47	New York	1.3
15	Alaska	4.4		**United States**	**2.8**	48	Connecticut	1.2
16	Idaho	4.3	32	Michigan	2.7	49	New Hampshire	1.1
17	Louisiana	4.2	32	Ohio	2.7	50	Rhode Island	0.3

Small states generally did better than large ones, as indicated by the fact that 31 states beat the national average gain. As was the case for employment, Western states generally did better than Eastern states. But there are exceptions in the strong personal income growth in **North Carolina**, which tied for first, and in **Alabama**, **Kentucky**, and **Mississippi**. Personal income in **Rhode Island** actually declined in the third quarter from the previous third quarter, but the fourth quarter change was a slight increase of 0.3%. **California** joined most Northeastern states in the list of poor performing state economies.

The sources of personal income growth were bad news for state tax collectors. From 1990 to 1991, personal income grew by $154.6 billion, an increase of 3.3%. Of the increase, about $75 billion, or just about half, resulted from an increase in non-taxable or lightly taxed transfer payments like Social Security (up 8%), Unemployment Compensation payments (up 48%), employee pensions (up 7%), and AFDC payments (up 10%). Income taxed by states fared less well, with dividends and interest up only 0.1% and wages and salaries up only 2.5%.

Housing Activity Suggests Changing State Patterns

Housing, as measured by the issuance of permits to construct new homes and apartments, can serve as a significant leading indicator of state economic activity. The table suggests possible longer term trends among the states.

Percentage Change In Residential Building Permits, First Quarter, 1991 And 1992

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Wyoming	129%	17	Rhode Island	51%	34	New York	29%
2	Montana	124	19	Missouri	49	35	Maine	28
3	Colorado	91	20	Tennessee	48	36	Georgia	26
4	Idaho	76	21	Arizona	47	37	Oregon	25
4	Iowa	76	21	Virginia	47	38	West Virginia	21
6	Illinois	75	23	Alabama	46	39	Nevada	19
6	New Jersey	75	23	Nebraska	46	40	Pennsylvania	16
8	Utah	69	25	Maryland	45	41	South Carolina	15
9	Kentucky	66	25	Michigan	45	42	New Mexico	14
10	Vermont	60	27	Mississippi	44	43	Florida	13
11	Louisiana	59	28	New Hampshire	42	44	Arkansas	7
12	Connecticut	58	28	Wisconsin	42	45	Delaware	6
12	Indiana	58	30	Massachusetts	41	46	South Dakota	4
12	Oklahoma	58	31	Texas	38	47	North Dakota	-4
15	Kansas	53	32	Ohio	33	48	California	-10
15	North Carolina	53	33	Washington	32	49	Alaska	-31
17	Minnesota	51		**United States**	**30**	50	Hawaii	-37

California's low rank (48th) and **Hawaii**'s rock bottom 50th suggest these formerly high-flying economies may be bringing more bad news for state governments. New housing permit growth was also below the national average in such fast-growing states as **Arkansas**, **Florida**, **Nevada**, and **Oregon**. Conversely, some of the New England states show better performance than the national average.

ECONOMIC PERFORMANCE AND FISCAL PROBLEMS

National economic performance in the period covered by the Economic Momentum Index (p. 2) has been so poor that outperforming other states and the national average is no guarantee that a state is avoiding fiscal problems.

Getting By In FY 1992

Practically all states have followed the same pattern in financial management during the current year (FY 1992). Budget shortfalls developed during the year as a result of spending overruns and revenue shortfalls. Those shortfalls were recognized early this year by lower revenue estimates and higher spending estimates. The top-ranked states haven't been immune from this process. Because expectations for economic performance were low to begin with, some low-ranked states like **Massachusetts** and **New Hampshire** have been reporting relatively good fiscal news.

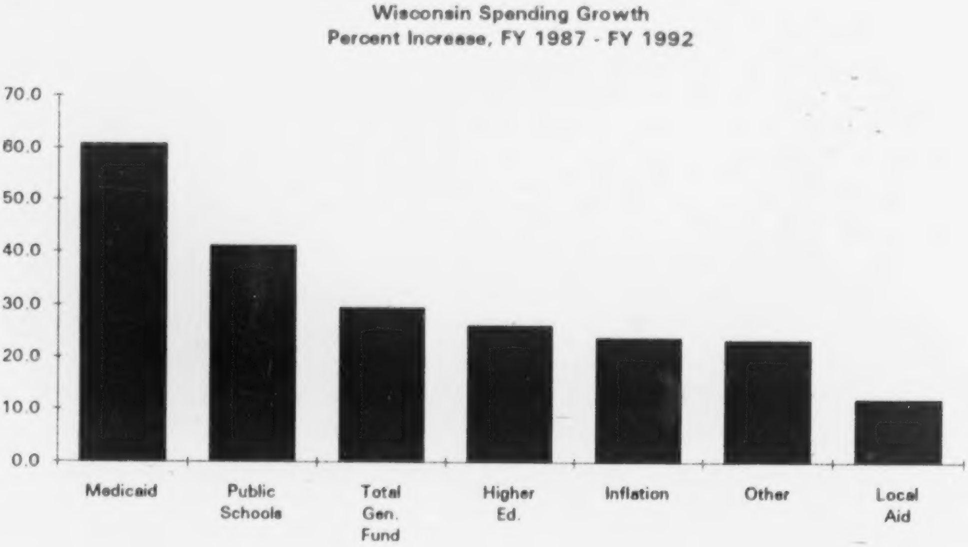
Against estimates as revised, *but not against estimates on which FY 1992 budgets were based when enacted*, the FY 1992 fiscal situation isn't a disaster. It isn't good either. **Reports** was recently asked by a reporter to identify states in good fiscal shape in FY 1992 and could only come up with a few. They were ones that improved their fiscal circumstances by steep tax hikes, with **Pennsylvania** as the best example.

As documented in previous issues, most states have used two devices to deal with their FY 1992 fiscal problems. The first is moving the problems into FY 1993. The second is some type of revenue raising measure. These consist of a few substantial general tax increases (e.g., in **Kansas**, **Maryland**, **Mississippi**, and **Tennessee**) and aggressive use of Medicaid provider taxes in many states. Practically all states have been parsimonious with increasing spending for such functions as school aid, employee pay increases, welfare payment increases, and new initiatives. But layoffs and actual cutbacks of previous spending levels are rare.

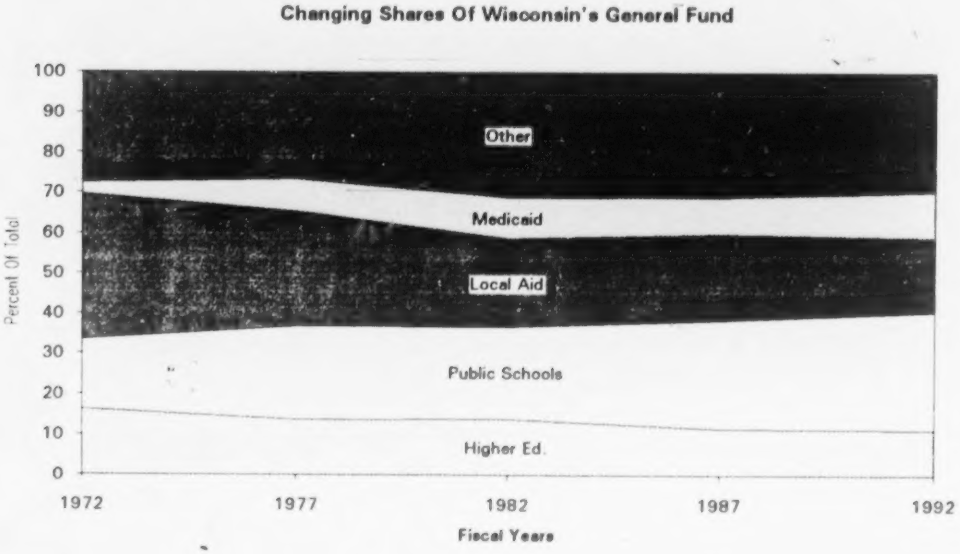
Higher Education And Local Aid Taking Big Hits

Higher education and aid to local government are the two exceptions to the tendency to avoid significant cutbacks this year. In these two programs, the impact of state cuts can be muted by raising revenue, by sharp tuition increases, and by higher local taxes.

Wisconsin may not be indicative of every state, but probably is a good indicator of what is occurring in many states as decisionmakers adjust to tighter fiscal circumstances. The first chart on p. 7 shows how other programs have outdistanced spending increases for local aid and higher education.



The graph below shows the changing shares of the general fund budget. While "Other" (top section) has remained constant, Medicaid and the schools have been increasing. Their gains have been losses for higher education and aid to local governments.



Economic Recovery Won't Solve All Problems

While the national economic news appears to be improving, don't expect good state fiscal news to follow. First, there is a residual of bad news in states that are lagging in the Index of State Economic Momentum. While some -- like **California**, **Illinois**, and **New Jersey** -- have announced large chunks of bad news, there may still be bad news to come in some of the others. Second, much of the bad news moved into FY 1993 is due to be discovered after the November elections.

Third, the use of one-time measures to balance FY 1993 has been so great that many states will be facing unusually difficult problems in balancing their FY 1994 budgets. This list includes the usual suspects, like **Michigan** and **New York.** Then there are states that have survived recession relatively nicely but used up their reserves and budget flexibility in the process: states like **Indiana** and **Minnesota**. Their ranks could be swelled by states where legislatures are reluctant to accept the budget-balancing measures being proposed by their governors this year, including **Massachusetts** and **Ohio**.

FEDERAL IMPACTS ON STATE DEVELOPMENT

The federal government currently is spending about $1.4 trillion a year, roughly 25% of gross domestic product. This much spending has colossal impacts on the distribution of economic activity, twice as large as either business investment or exports.

Chasing The Federal Dollar In New Places

State officials have long recognized this impact. They traditionally have been active in: (1) seeking new federal installations and trying to keep existing ones open, (2) encouraging grant policies and formulas benefiting their states, (3) encouraging other federal spending, such as agricultural subsidies and investments in water resource projects, that benefit their states, and (4) assisting state businesses in attempts to capture more of the federal procurement dollar.

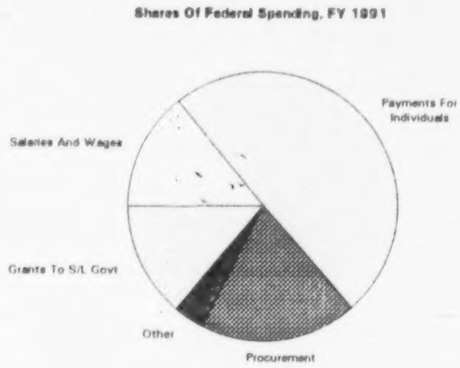
Success in these policies is becoming more difficult because of sharp changes taking place in the composition of federal outlays. While federal grant spending is rising rapidly (see Issue 11), most of the action is in Medicaid. There is little interest in modifying formulas for distribution of federal funds in other programs (see Technical Notes). Interest payments on the national debt are rising rapidly as the debt grows. But there is little states can do to maximize the portions of federal interest payments that go to their residents.

Besides grant money, state interest in the development impacts of federal policies has focused on federal procurement and the location of installations, and thus of employees receiving salaries and wages from the federal treasury. These (together known as "federal purchases" in national income accounts) have been declining. From the first quarter of 1991 to the first quarter of 1992, federal purchases dropped 2.2%.

Within this change, the federal government has been protecting its own payroll, which magnifies the reduction in federal procurement. Federal compensation rose 3.2% while purchases of goods and services declined by 6% for the year. If adjusted for inflation, this decline would be even greater. This results in competition among states as an exercise in trying to hold as much of the declining federal purchasing as possible, rather than competition for new investments that might stimulate state economies.

The Big Money (And Growth) Is In Retirement Payments

The major increases in federal spending, other than interest payments, is in the transfer payments made to individuals -- primarily Social Security but also federal employee retirement, veterans pensions, railroad employee retirement, and other smaller programs. These payments were 11% higher in the first quarter of 1992 than a year earlier.



The pie chart shows the distribution of federal spending for FY 1991 that can be associated with impacts on each state. It excludes interest on the national debt, foreign aid, and the small portion that federal officials can't trace by state.

The chart makes it clear that the big money is in payments to individuals, which is also the category that is growing most rapidly. Over the 1990s, its share will become even larger.

State Impacts Of Federal Payments For Individuals

The differences among states in per capita federal payments for individuals aren't dramatic. All states are within 20% of the average of the 50 states, excepting the three top and two bottom states. However, relatively small differences have enormous economic impacts because the amounts involved are so large. For example, **Florida**'s $579 per capita advantage means that the state gets $7.7 billion more in annual personal income as a result of its extraordinary concentration of these payments.

The table shows the per capita amounts of federal direct payments for individuals in FY 1991, which ended for the federal government on September 30, 1991.

Per Capita Federal Direct Payments For Individuals, FY 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Florida	$2,707	18	Iowa	$2,189	34	Vermont	$1,991
2	West Virginia	2,680	19	Virginia	2,176	35	Hawaii	1,952
3	Pennsylvania	2,609	20	Kansas	2,175	36	Indiana	1,947
4	Rhode Island	2,538	21	Arizona	2,164	37	Louisiana	1,947
5	Arkansas	2,414	22	Connecticut	2,164	38	Nevada	1,942
6	Massachusetts	2,404	23	Ohio	2,162	39	New Hampshire	1,911
7	New Jersey	2,306	24	Kentucky	2,138	40	South Carolina	1,910
8	Maine	2,303	25	Illinois	2,130	41	North Carolina	1,902
9	Alabama	2,281		**50-State Average**	**2,128**	42	Idaho	1,892
10	New York	2,267	26	North Dakota	2,118	43	California	1,864
11	Missouri	2,266	27	South Dakota	2,111	44	Colorado	1,829
12	Oregon	2,235	28	Tennessee	2,101	45	Minnesota	1,829
13	Oklahoma	2,220	29	Nebraska	2,100	46	Texas	1,814
14	Maryland	2,218	30	Delaware	2,065	47	Wyoming	1,813
15	Mississippi	2,203	31	Washington	2,041	48	Georgia	1,810
16	Michigan	2,202	32	Wisconsin	2,038	49	Utah	1,537
17	Montana	2,194	33	New Mexico	2,007	50	Alaska	1,204

While these payments include other programs, the totals are dominated by Social Security and related Medicare payments. Without migration, the highest ranked states would be those with a high proportion of elderly population with earnings histories sufficient to quality them for relatively high Social Security retirement and disability pensions. This explains the high ranks of states like **Pennsylvania** and **Rhode Island** and the low ranks of Western states (low percentage of elderly) and Southeastern states (low wage histories). States not fitting this pattern, such as **Arkansas** and **Florida**, have drawn Social Security and federal retirement recipients through migration.

Changes In State Shares Of Federal Payments

The percentage changes in these payments (p. 11) show impressive gains in nearly every state when compared with gains in other federal spending, inflation, and the private sector of states' economies. **Nevada** leads by a wide margin because it combined: (1) substantial gains from migration of affluent retirees, and (2) the advantage of starting from a low base, in the bottom third in per capita amounts. **Florida**, starting first in the nation, cannot easily sustain the rapid growth rate that brought it to first. It is 19th in terms of change.

Percentage Change In Federal Payments For Individuals, FY 1990-FY 1991

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	Nevada	14.6%	18	Oregon	9.6%	34	Illinois	8.4%
2	Alaska	12.1	19	Florida	9.3	35	Arkansas	8.3
3	Rhode Island	11.2	20	Utah	9.3	36	Wyoming	8.3
4	North Carolina	11.0	21	Kentucky	9.2	37	Pennsylvania	8.3
5	Maine	10.8	22	Virginia	9.2	38	Missouri	8.3
6	Delaware	10.6	23	Texas	9.1	39	Louisiana	8.0
7	Georgia	10.6	24	Idaho	9.0	40	Oklahoma	7.9
8	Vermont	10.1	25	Indiana	9.0	41	West Virginia	7.9
9	Connecticut	10.1	26	Hawaii	8.9	42	Montana	7.8
10	California	10.1		**United States**	**8.9**	43	Wisconsin	7.7
11	New Jersey	10.0	27	New Mexico	8.9	44	Minnesota	7.5
12	Arizona	9.9	28	New York	8.9	45	Iowa	7.3
13	Tennessee	9.9	29	Massachusetts	8.8	46	Kansas	7.2
14	Washington	9.8	30	Mississippi	8.7	47	South Dakota	7.1
15	Maryland	9.8	31	Colorado	8.6	48	Nebraska	6.3
16	South Carolina	9.7	32	Ohio	8.6	49	North Dakota	5.3
17	New Hampshire	9.7	33	Alabama	8.6	50	Michigan	4.8

The story in terms of fueling personal income growth and thus job growth is the bottom ten states. With their older populations, these Northern states are losing Social Security recipients about as rapidly as they are gaining new retirees. So their gains are little above the automatic escalation of Social Security payments resulting from: (1) inflation indexing of the pension amounts and (2) the increases that occur as persons with lower pension entitlements die and are replaced with new pensioners with somewhat higher pensions. The gains of the Northern states are cut because there is essentially no migration of retirees into them, while there is substantial out-migration of retirees.

Per Capita Gains From Federal Payments For Individuals

Yet another perspective is provided by looking at the one-year increase in per capita payments for individuals shown in the table on p. 12. These gains, like the percentage gains, are relatively small in some Northern states, particularly Michigan and the Dakotas.

Many of the biggest gainers are states like **Rhode Island** and **Maine**. They have stable total populations, but the average age is increasing. The other large gains occur in retirement destination states like **Nevada** and **Florida**.

Per Capita Increase In Federal Direct Payments For Individuals, FY 1990-FY 1991

Rank	State	Amount	Rank	State	Amount	Rank	State	Amount
1	Rhode Island	$256	18	Vermont	$183	34	Hawaii	$160
2	Nevada	248	19	Virginia	183	35	Montana	160
3	Florida	230	20	Washington	183	36	Idaho	157
4	Maine	225	21	Kentucky	181	37	Texas	151
5	New Jersey	209	22	Alabama	180	38	Iowa	148
6	Pennsylvania	200	23	Mississippi	177	39	Wisconsin	146
7	Connecticut	199		**50-State Average**	**175**	40	Kansas	145
8	Delaware	199	24	Georgia	174	41	Colorado	145
9	Maryland	198	25	Missouri	174	42	Louisiana	144
10	West Virginia	197	26	Ohio	171	43	South Dakota	141
11	Arizona	196	27	California	171	44	Wyoming	139
12	Oregon	195	28	South Carolina	170	45	Utah	131
13	Massachusetts	193	29	New Hampshire	169	46	Alaska	130
14	North Carolina	189	30	New Mexico	165	47	Minnesota	127
15	Tennessee	189	31	Illinois	165	48	Nebraska	125
16	Arkansas	186	32	Oklahoma	163	49	North Dakota	107
17	New York	185	33	Indiana	161	50	Michigan	102

Implications For State Policies

Recognizing The Value Of Retirees: For many reasons, retirees with Social Security pensions and Medicare coverage are valuable for economic development. First, they typically don't carry major government costs, particularly for states. They don't place demands on public schools or become eligible for AFDC payments. They place only minor demands on universities and the criminal justice system. With their Medicare coverage, they don't add to indigent health care costs and can't make demands on Medicaid (unless they go into nursing homes and exhaust their assets).

Second, they don't take jobs, but the money they bring creates substantial job opportunities for a large segment of new workers in the states in which they reside. This is particularly true in health care, but also in other service and maintenance positions and in retailing.

Because the amounts at stake are greater than with more obvious federal impacts, such as defense purchasing, states exhibit substantial interest in keeping retirees in the states where they worked as well as attracting them by migration. This interest is bound to grow with declining federal purchases and the rapid growth in Social Security and federal retirement payments.

Tax Concessions For Retirees: The conflicting pressures on state policy are most obvious in decisions on taxation of property transfers at death. On tax policy grounds, there are strong arguments for steep death (inheritance and estate) taxes. The estate clearly has the ability to pay and the tax obviously cannot reduce work incentives for the taxpayer, who is by definition deceased. In general, beneficiaries of rich dead people are rich live people, with exceptions to taxes easily crafted when beneficiaries are charities and poor people. Confronted with major differences among states in death taxes, older affluent persons can simply change their state of residence and avoid the higher taxes.

Concern with competition seems to be prevailing. There has been a movement among states to cut back estate and inheritance taxes to the federal pick up tax level. Taxes at that level simply reduce federal taxes dollar for dollar by the amount of the state tax, so every state levies them -- though **Nevada** hopped on this bandwagon only a few years ago. Reducing higher taxes has been an issue in states like **Massachusetts**, **Minnesota**, and **New York**. For example, the **Massachusetts** House recently voted nearly unanimously to increase the current exemption from $200,000 to $350,000, moving the state closer to the policies of other states.

Many states deviate from federal tax law by permitting Social Security payments to be excluded from taxable income. This policy generally was adopted without a strong emphasis on economic development impacts. Instead, it is part of a group of tax policies -- including homestead exemptions and the residuals of double exemptions for age in income tax laws -- that reflect a widespread perception that elderly persons are, as a class, poorer than non-elderly. They also reflect the concept that policies benefiting all elderly persons, rather than means-tested programs, are appropriate responses to poverty among the elderly.

BREAKFAST AT SCHOOL, IT'S COOL

The title of this article is the slogan of **Pennsylvania**'s version of a campaign encouraging breakfasts at school. The logic of the program is, as Governor Casey puts it, "You can't teach a hungry child." There is a strong correlation between eating breakfast and pupil achievement, though it isn't clear whether the breakfasts cause the achievement or some other factor(s) encourages both achievement and the morning meal.

In a year of tight budgets, expanding breakfast at school is one of the few initiatives attracting elected officials. Casey's budget reflects a 16% increase in state funding. Governor Finney signed legislation mandating increased participation by **Kansas** schools. **Missouri**'s new legislation mandates school district participation, but permits opting out by a school board vote. It is a compromise between some legislators, who wanted mandates, and school administrators who said they opposed mandates, not breakfasts.

The participation of low income children in school breakfast programs is highest in the low per capita income states of the Southeast, but **Idaho** and **Utah** combine low per capita income with low participation rates as shown in the table.

Percent Of Low-Income Students Getting School Breakfasts

Rank	State	Percent	Rank	State	Percent	Rank	State	Percent
1	West Virginia	56.6%	18	Florida*	33.6%	34	Indiana	18.1%
2	Tennessee	45.4	19	California*	32.9	35	New Jersey	17.6
3	Kentucky	44.7	20	Alabama	32.3	36	Pennsylvania*	17.6
4	North Carolina	44.3	21	Maryland*	31.8	37	Iowa*	17.4
5	Mississippi	43.9		**United States**	**31.5**	38	Minnesota	17.2
6	Texas	43.7	22	New Mexico	30.5	39	Montana	16.1
7	Arkansas	41.2	23	Washington	29.4	40	Nebraska	15.8
8	Oklahoma	39.3	24	New York*	29.2	41	Vermont	15.7
9	Virginia	39.3	25	Ohio	28.0	42	Oregon	14.5
10	Massachusetts*	38.5	26	Missouri	27.8	43	North Dakota	13.5
11	Delaware	37.4	27	Alaska	24.0	44	New Hampshire	13.3
12	Arizona*	37.2	28	Connecticut*	23.6	45	Idaho	12.9
13	South Carolina	36.5	29	South Dakota	23.5	46	Wisconsin	12.5
14	Georgia	36.0	30	Maine	22.6	47	Michigan	12.0
15	Hawaii	35.6	31	Illinois	20.1	48	Wyoming	11.5
16	Louisiana	35.3	32	Colorado	19.5	49	Kansas	10.8
17	Nevada	35.1	33	Rhode Island	19.3	50	Utah	6.7

The school breakfast program is a federally funded extension of the school lunch program. All states have an administrative role. About a third mandate participation by some schools, generally those with high concentrations of low-income students. The nine states indicated (*) on the table, among the most affluent ones, supplement the federal subsidies.

Differing state policies promoting breakfasts are probably the most significant factor explaining differing participation rates and changes in participation. From 1990 to 1991, participation rose 9.7% nationwide. **Washington** increased participation by 76%, followed by **Vermont** (47%), **Idaho** (40%), **Nebraska** (33%), **Connecticut** (32%), **Maine** (31%), and **Minnesota** (29%). Participation dropped 25% in **Indiana**, 10% in **Wisconsin**, and 2% in **Hawaii**.

WHAT IS A "FAIR RETURN?"

The concept of an appropriate *rate of return on investment*, or *cost of capital* is often garbled in public understanding and sometimes in legislation. The concept is well settled in some state policies, such as public utility regulation and tax administration. But it is a major source of dispute in dealing with health care providers and auto insurance companies.

Recognizing "Profit" As A Reasonable Cost

In some sense, "profit" is bad. For example, no one should profit from the misfortunes of others, thus all drug company "profits" are bad. In this sense, "profit" has no place in treating the sick, so there is something suspect about for-profit companies managing hospitals, but not-for-profit and county hospitals don't present these problems.

But on reflection, practically everyone recognizes that if investors can earn interest on loan investments, they will have to be given some reward if they are to make equity investments. That return looks more acceptable if packaged as "return on investment" or "rate of return" rather than profit. This is done in major programs in which government attempts to make payments based on "cost." As a result, the reimbursements allowed not-for-profit defense contractors, such as universities and research institutes, closely resemble those of for-profit defense contractors. State reimbursements under Medicaid for nursing homes and hospitals do not differ based upon the organizational form of the provider.

Under the U.S. Constitution, governments cannot take property without just compensation. To take land for a highway, for example, states must go through condemnation proceedings and pay just compensation. That compensation is basically market value, which depends upon the profits or returns that owners can get from using the property. But suppose that instead of taking the land, states do something that reduces the potential profits from the land? In extreme cases, this is also a "taking." For example, a new highway could cut off a corner of a farm and make access by farm equipment impossible. Zoning regulations, prohibitions against rebuilding beach properties, and limits on "noxious" uses such as having farm animals in urban areas are closer cases.

These cases arise frequently in public utility regulation, where the basic standard is that those who have invested in telephone and electric facilities must have a reasonable return on their investment. This doctrine has caused difficulties for state insurance reform measures, like California's Proposition 103. The California voters adopted a rate rollback that would have left some companies with no returns. The state's highest court ordered that the proposition be interpreted in a constitutional fashion, barring rate reductions except those based upon a finding that returns to insurance companies were unreasonably high.

State Definitions Of Reasonable Return

Some of the benchmarks for rates of return are shown in the table below.

Some Benchmarks for Rates Of Return on Equity Capital

Benchmark Basis	Annual Return Rate
Unregulated Private Companies, Last Ten Year Average	
Fortune Top 100	14.3%
General Motors	8.5
Exxon	19.1
IBM	7.2
State-Regulated Utilities, 1991	
Entergy	11.6
General Public Utilities	12.0
Gulf States Utilities	2.0
NICOR	15.2
GTE Corp. (telephone operations)	15.0
Dominion Resources	12.4
State Regulated Utilities, Average 1977-1991	
Before Disallowance Of Imprudent Investments	12.7
After Disallowances Of Imprudent Investments	11.7
Allowed Returns In Recent Rate Cases, Company (State)	
Bangor Hydro-Electric Co. (Maine)	12.2
Wisconsin Public Service Corp. (Wisconsin)	12.8
Dayton Power & Light Co. (Ohio)	13.0
Atlanta Gas Light Co. (Georgia)	12.0
Long Island Lighting Co. (New York)	11.6
Central Telephone Co. (Nevada)	12.0
Southern California Edison Co. (California)	12.6

The table shows the narrow range of what state utility commissions consider to be a reasonable return on equity capital, with the recent rate cases in the range of 12-13%. Actual returns of regulated utilities average about this level, but there is substantial deviation among individual companies. Disallowance of investment in nuclear facilities is the primary reason for the low returns exhibited by several of the companies in the table. Industrial returns are higher than regulated utility returns, reflecting regulators' conclusions that lower risks in utility operations merit lower returns.

Many states (and the federal government) also apply market tests of returns on capital -- debt as well as equity -- in selecting rates of interest for money owed by and to taxpayers for underpayments and overpayments. For example, **California**'s Franchise Tax Board set a rate of 10% for the first half of 1992. **New York**'s tax agency set a rate of 8% for the second quarter of 1992 for alcoholic beverage and cigarette taxes. **Iowa** is charging 11% while **New Jersey** is using 11.5% in 1992. **South Carolina**, which bases its rate on the federal one, is charging 8%, but also paying 8% on overpayments.

INDIGENT HEALTH COSTS, NEW JERSEY

There has been a rush of activity in many states to convert indigent health care costs to Medicaid financing wherever possible, as reported in detail in prior issues of **Reports**. The concept is being applied, for example, to the general assistance medical program in **Ohio.** It is proposed for **Arizona**'s state-funded health system and **Pennsylvania**'s lottery-funded prescription program for the elderly.

Not all states have followed this pattern. **New Jersey** is one that hasn't. Instead, New Jersey funds indigent hospital care through the Uncompensated Care Trust Fund. The Fund gets its money, about $900 million a year, from a "surcharge" on hospital bills which is now 19%. This surcharge has no advocates. Many New Jersey leaders, including organized business and labor, expected to replace it with an elaborate "play or pay" comprehensive health care plan. Small business and legislators balked at the steep costs to be imposed on employers, so the plan failed. So with great reluctance, but general acquiescence, the legislature has extended the Trust Fund periodically while looking for a long term solution.

The legal reason that state proposals for universal health care take the form of "play or pay" is that states need a legal hook for jurisdiction over employee benefit plans. The federal Employee Retirement Income Security Act (ERISA), which was designed primarily to regulate private pension plan funding, has been interpreted as preempting state control over employee benefit plan provisions and administration.

States can clearly regulate health insurance, but an increasing number of plans avoid this regulation. The most common avoidance is through "self-insurance," by which employers, not insurance companies, provide the benefits. Another variation is for unions to provide the health coverage, with employers contributing to the union-run plans. So the state proposals for universal care are built around the taxing power. They levy a payroll tax on employers ("pay") but provide a tax exemption for employers who provide health insurance for their own employees ("play").

Because "play or pay" wasn't enacted, New Jersey has been making private pay patients, union plans, and employer self-insurance pay the surcharge without the legal hooks of either taxing power or power to regulate insurance. The union plans sued in federal court claiming that ERISA precluded the state from imposing its 19% surcharge. They won in late May in federal district court. The order could be appealed, but New Jersey officials may not press the case if a legislative solution can be found. The governor commented that the attorney general had no choice but to defend the law, but "it is a law that must be changed."

While not explicitly covering self-insurance, the decision's logic would clearly apply to self-insurance as well. It doesn't apply to purchased insurance, but the state AFL-CIO (and probably other labor and employer organizations) have been looking for ways to take existing plans out of the insurance mode, and thus out of state regulation. Recognizing the pressure that the union action has put on state officials, the head of the New Jersey AFL-CIO commented, "The issue can no longer be ignored."

GOVERNING ARIZONA

Arizona's problems are so unique that they may not have any national significance. The state was the most recent to impeach a governor and the only one that couldn't resolve who would be the governor without a special election. That governor (R) has serious legal problems from past involvements in the savings and loan industry and lower approval ratings than the low approval ratings being logged by other governors. Twenty legislators have already indicated they are not running again, up from a previous record of 18 set in 1972.

The governor's theme of bringing business management to government led to a business-oriented task force to deal with issues like improved management, better organization, and cost cutting. This standard approach for newly-elected governors, particularly Republicans, has produced some non-standard results. Project SLIM (State Long-Term Improved Management) is itself expensive -- a $1.5 million contract with Coopers & Lybrand for consulting help and a $4.5 million appropriation request for FY 1993. Most such exercises rely on loaned business and/or state executives and small budgets, often contributed by business. Exceptions, like a recent **Connecticut** effort, spend more but only for one-time consultant reports on specific topics.

A prominent utility executive resigned his post as chairman of the steering committee. Another key member soon followed. Legislators, particularly in the Senate (D-led), may not fund Project SLIM, at least not at the levels the governor wants.

The legislature has problems of its own including gigantic ideological gulfs between its extreme members, well-publicized corruption, *and* all the other election-year problems associated with divided partisan control in a year of tight finances. More than average effort is devoted to debating reversals of past decisions, such as a mandatory insurance law and a "Drano tax." Two redistricting plans have been adopted. The legislature is suing the governor over veto power issues. Proposed tax cuts are being seriously discussed more or less independently of spending plans.

Newspaper editorials may not be a good place to get impressions, but the Arizona Republic's comments on April 19 merit some attention:

> *Would it be asking too much for the Arizona Legislature, which since early January has been simultaneously procrastinating on essentials and squabbling about trifles -- would it be asking too much for this garrulous assembly to get on with the real business of the state, adopt a budget and get out of town?*
>
> *Its lackadaisical work habits last year led to a 160-day regular session -- a record -- and four special sessions. This year's Legislature already has established a record for special sessions -- it is working on its eighth -- and easily could exceed last year's 160-day marathon. This is an inexcusable waste of time and money.*

RECORD PAY IN NEW YORK

New York's new health commissioner was originally to have been paid $160,000 a year, which **Reports** believes would have been the nation's highest pay for state cabinet officer. New York's governor makes $130,000. Some unusual situations permit higher pay than the governor: (1) doctors and psychiatrists working with patients in state institutions, (not working as administrators), (2) college professors with lucrative consulting sidelines, and (3) a few coaches at state universities.

The commissioner's pay was to consist of $98,000 salary and $62,000 for serving as president of Health Research Inc. The corporation is, in effect, an arm of the agency. Since 1953 it has been used to receive and disburse grants. The last New York commissioner also served as the corporate president, but received no extra compensation. The members of the corporation board are employees of the department. The corporation closely resembles the foundations run by many state universities. These are a constant source of controversy over supplementing salaries, whether they are subject to audit, and whether their funds must go through the appropriations process.

Some states permit private corporations in effect to supplement the pay of state executives. This would occur, for example, if a lawyer retained a partnership interest in a law firm, or a doctor received continuing compensation from a hospital with which he was affiliated. Such private supplementation is illegal in federal positions and in some states.

States generally permit employees to "moonlight" without restriction, so long as there is no hint of conflict of interest or double-dipping with their state job. For example, a state horticulturist could take a second job as a security guard or publish books on sports without restriction. There are controversial federal restrictions which states are not copying. The second income becomes more of an issue when an argument can be made that a state employee is being paid twice for the same job. This is the issue when Members of Congress accept payment for giving speeches.

Nine months of Senate inaction on the New York health commissioner nomination led in May to the nominee's agreement to forgo the extra compensation The legislature is expected to confirm the appointment and pass legislation providing for more oversight of operations like Health Research, Inc.

This is the season in which some leading state figures are releasing tax returns, which shed light on several practices. Governor Cuomo reported $124,200 in compensation for eight speeches, an average of over $15,000 a speech, mixed with uncountable numbers of appearances for which he did not charge. He gets a salary of $130,000, but takes a charitable deduction of $30,000 for turning part of it back to the state.

Governor Clinton is paid a stated salary of $35,000, but also has access to a "public relations fund" with little restriction on its use. If such money is used for personal purposes, it is taxable. The Clintons reportedly counted $19,000 from that source as CY 1990 income but had no comparable income in CY 1991. The Arkansas governor earned only $5,500 in honoraria in 1991.

Historically, some local officials in England were paid by fees. These "fee office" traditions have been eliminated throughout most of the United States, but a few examples persist.

In **Mississippi**, circuit and chancery clerks, who are elected officials, keep the fees they collect for issuing licenses and maintaining records. They pay their expenses, which they determine, from the fee income and keep the rest. Legislation is being considered to limit the take-home pay of these officials to compensation equal to the governor's, currently $75,800. Over a dozen of these officials would take a pay cut if the legislation passes.

EDUCATION REFORM IN MISSISSIPPI

How little has been happening on the 1980s education reform agenda (see Issue 10) was underlined by the reforms that passed with the Mississippi legislature's override of the sales tax increase bill. The only mandatory reforms are management items not inherently requiring significantly higher spending: (1) a mandated five-year plan for community involvement, (2) a requirement for public hearings on school budgets, and (3) an annual report card on local school performance, including test scores, from the state education agency. All other reforms are optional with the state board or local districts. This list includes: (1) relaxing accreditation standards (including past class size maximums and school day length minimums) to encourage innovation, (2) pilot use of summer semesters for remedial work, (3) experiments with gradeless schools, and (4) summer kindergarten.

MISCELLANY

State Directories

If the number of publications aimed at state and local officials with a glossy format and slick advertising is an indicator, there is increasing recognition of state impacts on businesses, both as a customer and a regulator. In the past decade, two standbys published by organizations of state officials (NCSL's State Legislatures and CSG's State Government) have been joined by City & State (Crain Communications) and Governing (Congressional Quarterly). The latest entry is to be Intellectual Ammunition For State Legislators to begin monthly publication in July. In its promotional literature, its publisher, The Heartland Institute (634 S. Wabash Ave., Chicago, IL 60605), criticizes Governing and State Legislatures as having a "liberal bias," producing "articles calling for higher taxes, greater regulation, and higher government spending."

The electronic age has improved the availability of directories of state officials. The Council of State Governments is the closest thing to an official collector of information with hard copy biennial publications: the Book Of The States, State Officials Classified By Function, 1991-92, and State Legislative Leadership, Committees, & Staff, 1991-92. NCSL maintains up-to-date information on individual legislators as well as staffs in forms that can be accessed selectively and electronically, in hard copy, and as printed labels. Thus NCSL is always the place to start asking about legislative branch directories. NGA has similar information on the much smaller universe of governors and immediate staffs. Associations of state agency directors like the American Association of State Highway and Transportation Officials and Federation of Tax Administrators keep current lists of their members, often cross-classified by functions within agencies. Some are sold. Most aren't, but are available for some purposes (e.g., research, but not selling insurance).

Commercial directory publishers maintain lists of state officials with excellent capabilities for electronic retrieval. The most active appears to be the Monitor Publishing Company (104 Fifth Ave., New York, NY 10011). It publishes the State Yellow Book four times a year with over 1000 pages of names, titles, addresses, and phone numbers. There are also private publishers in individual states. For example, the California Journal (1714 Capitol Ave., Sacramento, CA 95814) publishes the California Political Almanac and has also ventured into the national market with the 50-State Legislative Directory.

There is so much information in individual state capitols that Government Research Service (701 Jackson, Topeka, KS 66603) makes a business of tracking it. It gives away (800-346-6898) a directory, State Bill Drafting Manuals, to provide a basis for sending brochures on its other publications. They include the periodical Government & Politics Alert, (about information sources), a legislative telephone hotline directory, State Legislative Sourcebook (information for each state on contact points, newsletters, blue books, and more), and State Reference Publications (a state-by-state listing of statistical sources, biographies of legislators, and much more). It also has a nine-page appendix on national sources (which describes **State Policy Reports** as "excellent quality").

Secession And Dividing States

Dividing nations has become a hot world topic. Examples are the USSR, Yugoslavia, and serious discussion of independence for Scotland and Quebec. Secession hasn't drawn any interest in the U.S. since the 1980s when **Alaska** voters approved a statehood commission to reexamine whether becoming a state was a good idea. Historically, a few American states split from other states, as **Maine** did from **Massachusetts**. The last example was the division of **West Virginia** from **Virginia** when the old Commonwealth of Virginia couldn't agree on which side to take in the Civil War.

The latest move is to split Northern **California** from the rest of the Golden State. The movement, spurred by a member of the California Assembly, is being seized by county officials to emphasize their discontent. The area from San Francisco north to the Oregon border is generally rural, strong in natural resources but little else. Local economies are under pressure from federal and state environmental restrictions and from state-local fiscal relationship changes that seem to work better for Southern than Northern California. Advisory referendums supporting secession were approved in June in 27 counties.

The parallel move in the 1980s was to split **Michigan**'s Upper Peninsula away from the Lower Peninsula. The move received some study, but never serious consideration. The purpose was to dramatize alleged neglect by state government. The same thought is behind T-shirts appearing in Southwest **Kansas**. They show a tornado lifting the geographic area out of Kansas and say, "Toto, We're Not In Kansas Anymore!"

They were a protest against school equalization plans being considered in the legislature. The plans, now approved, involve a minimum property levy, reduced school aid to affluent districts, and higher state taxes. The net effect on districts in the Southwest with a high per pupil tax base could be both higher property taxes and less state aid. Voters in seven Kansas counties supported a new state in non-binding referendums in the April primary. Over 100 advocates, mostly county commissioners, have met to discuss concepts. One plan involves getting a total of 29 counties to join the movement, which would mean 220,000 people in 29% of the state's land area would secede.

Turnpikes And Independent State Authorities

The governors of **Massachusetts** and **New York** are eyeing resources from their **turnpike authorities** for non-turnpike purposes. In **Massachusetts**, the turnpike is being criticized as a fiefdom with little responsiveness to political control, though this criticism is primarily heard from the new administration (R) rather than legislative leaders (D). The governor is interested in selling the toll facilities. A recent study indicates they are worth about a billion dollars.

New York's governor wants to give the Thruway Authority control over the canal system and power to fund local projects such as waterfront development in Buffalo and Syracuse. Similar expansions of authority have already taken place with the Port Authority of New York and New Jersey. The Thruway debt is scheduled to be paid off in 1996 and the tolls eliminated. The new plan would extend the tolls. Critics say the plan is an attempt to revive the governor's "New, New York" plan to stimulate the state's economy -- an attempt to borrow without appearing to create new debt for the state itself.

Also Noted

The state programs to stimulate the economy announced early this year haven't turned into much. **Maine** legislators opted not to put major bond issues on the ballot. The issues approved by **California** voters in June were for routine school and university construction, with proposals for transit, housing, water, and waste disposal not making the cut. Action in **New Jersey** consists primarily of lifting a limit on spending from previously approved bonds. The U.S. Secretary of Transportation is still complaining that many states aren't moving fast enough to obligate federal highway funds.

An example of why **Reports** (Issue 9) dismissed City & State rankings of state fiscal stability as "junk ratings" is the complaint from **Oklahoma**'s comptroller that the publication used 76% as the gap between estimated and actual revenue rather than the 3% experienced. He complains that he can't recalculate the ratings to show what effect the correction would have on the state's ranking.

To its credit, C&S published the complaint (5/4) as well as publishing (6/1) a letter from Steven Gold (Center for the Study of the States) objecting to ranking **Tennessee** #1, criticizing the ratings, and concluding, "It would be better not to do it at all than publish such a misleading analysis." **Iowa**'s criticism, which wasn't published, is that it is being judged by GAAP standards while other states aren't.

TECHNICAL NOTES

Index Of Economic Momentum: The index, published quarterly, is the average of the differences between each state's latest one-year change and the national change in (1) population, (2) personal income, and (3) employment. The measure shows how each state's economy is performing in relation to the nation and other 49 states. Employment data are from the Bureau of Labor Statistics. Personal income and population data come from the Department of Commerce.

Fiscal Problems: It is difficult to assess changes in state spending for local aid because some aid takes the form of lower revenues (e.g., credits for local taxes paid) and some is off-budget (e.g., forms of shared revenues). Wisconsin was chosen as an example because the Wisconsin Taxpayers Association prepared material that incorporates some of the hard-to-measure changes.

Federal Impacts: The national statistics were calculated from the national income accounts in the Survey Of Current Business (April). The state-by-state and summary federal FY 1991 data are from the Census Bureau's Federal Expenditures By State For Fiscal Year 1991. Many formulas for allocating federal funds are hard to defend on any basis other than the political difficulties in making changes without a sweetener of more federal funding. For example, the Maternal and Child Health Services Block Grant funding is 90% controlled by factors in effect when 10 categorical programs were consolidated in 1981. A recent General Accounting Office report (Maternal And Child Health: Block Grant Funds Should Be Distributed More Equitably) finds that 60% of the differences in state allocations "are unrelated to either the number of beneficiaries or taxpayers' ability to pay."

School Breakfasts: The data on breakfast program participation comes from the Food Research & Action Center (1875 Connecticut Ave., NW, Washington, DC 20009). This foundation-funded group is a good source of information on hunger, including 50-state statistics.

Fair Returns: The industrial returns are from Fortune (4/20) and the utilities' from company annual reports." The 1977-1991 averages are from Public Utilities Fortnightly (4/15) and the allowed returns from the March and April issues of Fortnightly.

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